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In The

Supreme Court of the United States

PHILIP MORRIS USA, INC., *ET AL.*,

Petitioners,

v.

STATE OF MINNESOTA,

Respondents.

On Petition for a Writ of Certiorari to the Minnesota Supreme Court

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In 1998, the State of Minnesota (the "State") settled a civil lawsuit against the petitioner tobacco manufacturers for reimbursement of health care costs attributed to tobacco. The settlement agreement released petitioners and their distributors from "liabilities of any nature whatsoever," including "statutory" liability, "for reimbursement for [state] health care costs allegedly associated with use of or exposure to Tobacco Products." Notwithstanding this release, in 2005, Minnesota enacted a Health Impact Fee on cigarette sales "to recover for the state health costs related to or caused by tobacco use." The Minnesota Supreme Court held that the Health Impact Fee did not impair the settlement agreement, and thus did not violate the Contracts Clause, because the contract did not contain an "unmistakable" promise by the State to refrain from imposing liability through legislation to recoup for the State's health costs related to or caused by tobacco use.

The question presented is:

Whether legislation that impairs a state's proprietary contract violates the Contracts Clause only when the contract contains an unmistakable promise by the state not to alter the terms of the contract through subsequent legislation.

PARTIES TO THE PROCEEDINGS BELOW AND RULE 29.6 STATEMENT

Petitioner Philip Morris USA Inc. is a wholly-owned subsidiary of Altria Group, Inc. Altria Group, Inc. is the only publicly held company that owns 10% or more of Philip Morris USA Inc.'s stock.

Petitioner R.J. Reynolds Tobacco Company is a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., which is a wholly-owned subsidiary of Reynolds American Inc. Brown & Williamson Holdings, Inc., an indirect wholly-owned subsidiary of British American Tobacco, p.l.c., owns approximately 42% of the stock of Reynolds American, Inc.

Petitioner Lorillard Tobacco Company's parent company is Lorillard, Inc., which is not a publicly held company. The parent company of Lorillard, Inc. is Loews Corporation. Loews Corporation is a publicly held company. In addition, Loews Corporation has issued a publicly traded stock which tracks the performance of Lorillard, Inc. and its subsidiaries including Lorillard Tobacco Company. That stock is referred to as Carolina Group Stock.

Petitioner A.H. Hemmel Candy & Tobacco Co. has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Petitioner Henry's Foods, Inc. has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Petitioner Sandstrom's, Inc. has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Petitioner Johnson Candy and Tobacco Co. of Brainerd, Inc. is a wholly-owned subsidiary of petitioner Granite City Jobbing Company, Inc.

Petitioner M. Amundson Cigar & Candy Company LLP has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Petitioner The Watson Companies, Inc. has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Petitioner Granite City Jobbing Company, Inc. has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Petitioner Minter-Weisman Co. is a wholly-owned subsidiary of Core-Mark International, Inc. Core-Mark International, Inc., is a wholly-owned subsidiary of Core-Mark Holdings III, Inc. Fifty percent of the stock of Core-Mark Holdings III, Inc., is owned by Core-Mark Holdings I, Inc., and fifty percent of the stock of Core-Mark Holdings III, Inc., is owned by Core-Mark Holdings II, Inc. Both Core-Mark Holdings I, Inc., and Core-Mark Holdings II, Inc. are wholly-owned subsidiaries of Core-Mark Holding Company, Inc., a publicly traded company.

Petitioner Segal Wholesale, Inc. has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Petitioner Tyler Wholesale, Inc. has no parent, and there is no publicly held company that holds 10% or more of petitioner's stock.

Respondent is the State of Minnesota.

Other parties to the proceedings below were intervenors Common Wealth Brands, Inc., and Counsel of Independent Tobacco Manufacturers of America, and amicus Governor Tim Pawlenty.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Philip Morris USA; R.J. Reynolds Tobacco Company; Lorillard Tobacco Company; A.H. Hermel Candy & Tobacco Co.; Henry's Foods, Inc.; Sandstrom's, Inc.; Johnson Candy and Tobacco Co. of Brainerd, Inc.; M. Amundson Cigar & Candy Company LLP; The Watson Companies, Inc.; Granite City Jobbing Company, Inc.; Minter-Weisman Co.; Segal Wholesale, Inc.; and Tyler Wholesale, Inc. ("Petitioners") respectfully petition for a writ of certiorari to review the judgment of the Supreme Court of Minnesota in this case.

OPINIONS BELOW

The decision of the Minnesota Supreme Court, App., *infra*, 1a-28a, is reported at 713 N.W.2d 350. The decision of the Minnesota District Court, Second Judicial District, Ramsey County, App., *infra*, 29a-38a, is not reported in N.W.2d, but is available at 2005 WL 3478647.

STATEMENT OF JURISDICTION

The judgment of the Minnesota Supreme Court was entered on June 21, 2006. *See* App., *infra*, 40a. This Court previously granted petitioners an extension of time to file a petition for writ of certiorari up to and including November 3, 2006. *See Philip Morris USA Inc. v. Minnesota*, No. 06A226 (Alito, J., in chambers) (Aug. 25, 2006). The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

The Appendix, App., *infra*, 41a-44a, reproduces the Contracts Clause of the United States Constitution, U.S. Const. art. I, § 10, cl. 1, Minn. Stat. § 16A.725, and Minn. Stat. § 256.9658.

INTRODUCTION

The Minnesota Supreme Court's decision presents an important question concerning the extent to which a state must keep its word when it enters into a proprietary contract with a private party. Under the Minnesota court's decision, a state is free to enact legislation that impairs its proprietary contracts unless the contract contains an "unmistakable" promise not to enact that specific legislation. The application of the so-called "unmistakability doctrine" to a state's proprietary contracts, as a practical matter, would eliminate the protections of the Contracts Clause as to most of a state's contracts because few, if any, contracts would satisfy the doctrine's strict requirements. Allowing the Minnesota Supreme Court's decision to stand thus would severely undermine the ability of the government to contract with the private sector and would violate the Contracts Clause's basic constitutional protection against government overreaching.

This Court should grant certiorari because the decision below directly conflicts with more than a century of this Court's Contracts Clause jurisprudence precluding a state from breaching its proprietary contracts through subsequent legislation. *See, e.g.*, *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 25 (1977); *Murray v. Charleston*, 96 U.S. 432 (1877). In applying the unmistakability doctrine here, the Minnesota court relied on a flawed reading of the plurality opinion in *United States v. Winstar Corp.*, 518 U.S. 839 (1996) -- a case that, properly read, provides no support for the decision below.

This Court should also grant certiorari because the Minnesota Supreme Court's decision deepens confusion among the lower courts in this area of the law. Indeed, lower courts have expressly asked for clarification of the *Winstar* plurality opinion and, in particular, whether the unmistakability doctrine applies to proprietary contracts. This case presents the Court with an excellent vehicle to resolve this recurring issue and clarify this uncertain area of the law.

STATEMENT

A. Minnesota's 1994 Suit for Reimbursement of Tobacco-Related Health Care Expenditures.

In 1994, the State of Minnesota, together with Blue Cross & Blue Shield of Minnesota, filed a civil lawsuit against the petitioners and other tobacco manufacturers in the District Court for Ramsey County, Minnesota. Minnesota sought "to vindicate the State's *proprietary interest* in enforcing the State's right to damages for economic injuries to the State which were caused by the unlawful actions of the cigarette industry." App., *infra*, 50a (emphasis added). As with the private insurer's claims, the "premise" of the State's suit as stated in the complaint was that "the [tobacco] industry – and not the State of Minnesota, or its citizens . . . – should pay for the staggering health costs" incurred by the state and private insurance programs that were attributable to tobacco use. Minn. Supp. App. 110.[1]

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[1] Citations to the Supplemental Appendix submitted before the Minnesota Supreme Court appear as "Minn. Supp. App."

B. Minnesota's 1998 Settlement and Release of All Future Claims for Health Care Costs Attributable to Tobacco Use.

In 1998, after extensive pretrial and trial litigation, Minnesota and the petitioner tobacco manufacturers signed a settlement agreement that settled and released the claims in Minnesota's suit, as well as all past claims, and "any future claims for reimbursement for health costs allegedly associated with use of or exposure to Tobacco Products." App., *infra*, 108a. The parties agreed that the settlement agreement would "be final and binding upon all Parties" upon approval by the Ramsey County District Court. App., *infra*, 114a. That court approved the settlement agreement on May 8, 1998. App., *infra*, 135a.

The settlement agreement obligates the tobacco manufacturers to pay hundreds of millions of dollars in "annual payments" to Minnesota as reimbursement for the State's health care costs attributable to tobacco. App., *infra*, 104a-105a. Each annual payment is "in satisfaction of all of the State of Minnesota's claims for damages incurred by the State in the year of such payment or earlier years . . . including, without limitation . . . claims for [tobacco-related] health care expenditures." App., *infra*, 101a. Pursuant to the settlement agreement, the tobacco manufacturers have paid Minnesota a total of approximately $2.25 billion to date and will continue to make payments in the hundreds of million of dollars each year in perpetuity. App., *infra*, 102a-105a. In addition to the monetary payments, the tobacco manufacturers agreed to significant restrictions on their future conduct. App., *infra*, 110a-114a.

In return for these monetary and other present and future contractual obligations, the primary tangible benefit Minnesota provided to the tobacco manufacturers under the settlement agreement was a broad, comprehensive "Release and Discharge" of all claims and liabilities imposed by the State – past, present, and future – for reimbursement of its

health care costs attributable to tobacco. App., *infra*, 107a-108a. The Release provides:

> [T]he State of Minnesota shall release and forever discharge all [Settling] Defendants and their . . . distributors . . . from any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly, representatively, derivative or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:
>
> . . . .
>
> b. for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

App., *infra*, 107a-108a. The State further "covenant[ed] and agree[d] that it shall not hereafter sue or seek to establish civil liability against any person or entity covered by [the Release] based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agree[d] that this covenant and agreement shall be a complete defense to any such civil action or proceeding." App., *infra*, 108a. The Release specifically names the tobacco manufacturers' distributors as released parties. App., *infra*, 107a.

C. Minnesota's Enactment of a Health Impact Fee To Recover State Health Care Costs Attributable to Tobacco.

In 2005, Minnesota enacted a "Health Impact Fee," imposing liability on tobacco distributors -- including petitioners' distributors -- for a new 75-cent per pack fee on all tobacco products. The Fee was specifically and expressly enacted "to recover for the state health costs related to or caused by tobacco use," Minn. Stat. § 256.9658(1) -- the same "health care costs" released by the settlement agreement.

When the Governor of Minnesota proposed the Health Impact Fee, he explained that it was "related to the cost of smoking attributable expenses incurred by government health care programs." Minn. Supp. App. 166. The Governor further explained that the 75-cent amount of the fee "was arrived at based on the impact of tobacco use o[n] the state's publicly funded health programs." Minn. Supp. App. 167.

The Health Impact Fee legislation mandates that revenues collected under the Health Impact Fee be credited to a "Health Impact Fund" to be used to pay health care costs incurred by state insurance programs that Minnesota attributes to smoking. Minn. Stat. § 256.9658(9); Minn. Stat. § 16A.725(1). Each year, the Minnesota Commissioner of Human Services must "certify to the commissioner of finance the state share, by fund, of tobacco use attributable costs for the previous fiscal year in Minnesota health care

programs." Minn. Stat. § 16A.725(2). The Minnesota Commissioner of Finance must then "transfer from the health impact fund to the general fund an amount sufficient to offset the general fund cost of the certified expenditures." Minn. Stat. § 16A.725(3).

D. The Minnesota District Court Proceedings.

Petitioners filed a Motion for Enforcement of Settlement Agreement in the District Court for Ramsey County, Minnesota, arguing, among other things, that the application of the Health Impact Fee to petitioners' products impaired Minnesota's obligations under the settlement agreement and therefore violated the Contracts Clause of the United States and Minnesota Constitutions. The district court agreed, holding that the Health Impact Fee "seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement," namely the "reimbursement of tobacco-related health care costs." App., *infra*, 32a.

The district court refused to apply the unmistakability doctrine. App., *infra*, 36a. It noted that, in certain government contracts, the application of the unmistakability doctrine prevents a government from "waiv[ing] its sovereign powers unless it does so in unmistakable terms." App., *infra*, 36a. However, the district court held that the doctrine applies only to contracts that involve the surrender of a sovereign power -- not to contracts that, like the settlement agreement in question, were entered into by a state in its proprietary capacity. App., *infra*, 36a. As the district court explained, the settlement agreement "involves neither the eradication [n]or usurpation of [the State's] sovereign power but its assent to a contract, of the nature and type, which the state enters into every day in a variety of situations." App., *infra*, 36a.

The district court therefore held that the Health Impact Fee impaired the settlement agreement in violation of the Contracts Clause of the Minnesota Constitution (which

Minnesota courts have uniformly interpreted to be coextensive with the federal Contracts Clause):

> The state is bound, like any other party is bound, to the contracts to which it freely and knowingly enters, and from which it benefits. For the state now to argue that it is not bound by its contract undermines and potentially eviscerates the constitutional provision contained in Article I, Section 11 of the Minnesota Constitution which provides that "No . . . law impairing the obligation of contracts shall be passed."

App., *infra*, 36a.

E. The Minnesota Supreme Court Proceedings.

The Minnesota Supreme Court granted direct review and reversed. Relying almost exclusively on its interpretation of this Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), the court held that the unmistakability doctrine applied and that the agreement did not contain an unmistakable promise that the State would not subsequently enact legislation impairing the contract. The Minnesota court thus rejected petitioners' federal and state Contracts Clause argument. *See* App., *infra*, 24a-25a.[2] Even though the

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[2] Although the Minnesota Supreme Court specifically addressed only the Contracts Clause of the Minnesota Constitution, petitioners raised the Contracts Clause of both the United States and Minnesota Constitutions before both the district court and the Minnesota Supreme Court, *see* App., *infra*, 46a, 65a-72a, 92a, and Minnesota courts have uniformly interpreted the two Contracts Clauses to be coextensive. *See Christensen v. Minneapolis Mun. Employees Ret. Bd.*, 331 N.W.2d 740, 750-52 (Minn. 1983); *State ex rel. Hatch v. Employers Ins. of Wausau*, 644 N.W.2d 820, 833 (Minn. Ct. App. 2002). The Minnesota Supreme Court's holding, therefore, addressed a federal question, and this Court has jurisdiction to

(Continued...)

settlement agreement was entered into by the State in its proprietary capacity, the court found that the unmistakability doctrine applied. To the court, the dispositive fact was not whether the State entered into the contract in its sovereign or proprietary capacity, but whether the consequences of enforcing the obligation would be to bar the enforcement of legislation. App., *infra*, 18a-19a. In the court's view, if a state acts through legislation, the unmistakability doctrine applies since the complaining party would be taking the position that the contract barred the state from engaging in a sovereign act. Thus, the court held that, because petitioners were seeking to avoid "the exercise of the state's sovereign power[] to tax," the unmistakability doctrine applied. App., *infra*, 18a.

Applying the unmistakability doctrine, the Court held that the broadly worded release was "insufficiently specific to meet the requirements of the unmistakability doctrine." App., *infra*, 21a. Accordingly, the Minnesota Supreme Court concluded that "the Health Impact Fee did not impair [the settlement] agreement and therefore did not violate the Contracts Clause." App., *infra*, 24a-25a.

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review its determination. *See, e.g., Delaware v. Prouse*, 440 U.S. 648, 652 (1979) (This court has jurisdiction to review a state court's judgment where a state constitutional provision "will automatically be interpreted at least as broadly as [its federal counterpart]."); *Enter. Irrigation Dist. v. Farmers' Mut. Canal Co.*, 243 U.S. 157, 164 (1917) ("[W]here the non-Federal ground is so interwoven with the [federal question] as not to be an independent matter, or is not of sufficient breadth to sustain the judgment without any decision of the other, our jurisdiction is plain."). Because petitioners challenged the Health Impact Fee under both the federal and state Contracts Clauses, the Minnesota Supreme Court necessarily reached both in order to uphold the Health Impact Fee.

REASONS FOR GRANTING THE PETITION

I. THIS COURT SHOULD GRANT REVIEW BECAUSE THE MINNESOTA SUPREME COURT'S DECISION CONFLICTS WITH NEARLY 130 YEARS OF THIS COURT'S CONTRACTS CLAUSE PRECEDENT.

The Minnesota court's decision, if let stand, would allow any state to impair virtually any proprietary contract as long as the state does so by enacting legislation that is not expressly and specifically barred by the contract. Such a ruling would eliminate any meaningful protection of the Contracts Clause with respect to most state contracts. This Court should grant certiorari to vindicate the basic principle underlying the Contracts Clause -- that "government must keep its word." *See* L. Tribe, American Constitutional Law 470 (1978).

The parties agree that the settlement agreement is a proprietary contract because it settled a lawsuit in which the State and a private insurer -- as third-party payers of medical care -- sought to recoup some of their expenditures. App., *infra*, 13a.[3] In particular, the purpose of the underlying lawsuit -- in the state's own words -- was "to vindicate the State's *proprietary* interest in enforcing the State's right to damages for economic injuries to the State which were caused by the unlawful actions of the cigarette industry." App., *infra*, 50a (emphasis added). The settlement agreement

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[3] When bringing and settling such a suit, the government uses its "proprietary or business [power], by means of which [government] acts and contracts for the private advantage of the inhabitants" in a proprietary capacity, and not its "legislative or governmental [power], by virtue of which [government] controls its people as their sovereign." *Omaha Water Co. v. City of Omaha*, 147 F. 1, 5 (8th Cir. 1906).

released and discharged this proprietary interest in exchange for monetary and other compensation. For this reason, at oral argument before the Minnesota Supreme Court, the State's attorney not only conceded the proprietary nature of the contract but "insist[ed] upon it."

Despite the contract's proprietary nature, the Minnesota Supreme Court applied the "unmistakability doctrine" to uphold the State's impairment of the settlement agreement. The unmistakability doctrine provides that, when interpreting certain government contracts, "sovereign power . . . will remain intact unless surrendered in unmistakable terms." *Winstar*, 518 U.S. at 872 (plurality) (quoting *Bowen v. Pub. Agencies Opposed to Social Sec. Entrapment*, 477 U.S. 41, 52 (1986)). The unmistakability doctrine has been held by this Court to apply, however, only when the government entered into a contract in its sovereign capacity and either surrendered its sovereign power to the contracting party or granted the private party a general exemption from the future exercise of sovereign power. *Id.* at 878-79.[4] It has not been held to apply when the government enters into a business-type contract.

Indeed, for over 130 years this Court has interpreted the Contracts Clause to prevent states from violating their own proprietary contracts through legislation, without applying the unmistakability doctrine. This Court has held that, when the government acts as a private contracting party, "its rights and duties are therein governed generally by the

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[4] Thus, the plurality opinion in *Winstar* explained that the unmistakability doctrine applies when "the Government is subject either to a claim that its contract has surrendered a sovereign power (*e.g.*, to tax or control navigation), or to a claim that cannot be recognized without creating an exemption from the exercise of such a power (*e.g.*, the equivalent of exemption from Social Security obligations)." *Id.* at 878.

law applicable to the contracts between private individuals." *Lynch v. United States*, 292 U.S. 571, 579 (1934); *see Winstar*, 518 U.S. at 887 n.32 (1996) ("[T]he Government is ordinarily treated just like a private party in its contractual dealings."); *Wood v. Lovett*, 313 U.S. 362, 368-69 (1941) ("[T]he obligation of the State arising out of [a contract] is as much protected by Article I, § 10, as that of an agreement by an individual.").

For example, in *Murray v. Charleston*, 96 U.S. 432 (1877), the City of Charleston, South Carolina, entered into a proprietary contract with private individuals by issuing bonds at a fixed six percent rate of interest. When this rate later became above-market, making the contract no longer beneficial to the City, the City sought to use its sovereign taxing power to recoup its losses by seeking to tax the bondholders on the interest collected in an amount that would reduce the effective rate of interest. This Court explained:

> In substance, [Charleston] say[s] to the creditor: "True, our assumption was to pay to you quarterly a sum of money equal to six per cent per annum on the debt we owe you. Such was our express engagement. But we now lessen our obligation. Instead of paying all the interest to you, we retain a part for ourselves [by operation of a newly enacted tax]."

Id. at 443.

The contract did not specifically bar the City from imposing such a tax. Nonetheless, this Court held that the City's attempt to nullify the contracting party's financial benefit by levying a tax was an unconstitutional impairment of contract barred by the Contracts Clause. *Id.* at 448. This Court rejected the argument that a state, or its political subdivisions, could use its sovereign powers to alter a contract it entered into in its proprietary, and not sovereign, capacity:

> States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons.

Id. at 445. Most importantly, this Court did not apply the unmistakability doctrine to interpret the government's obligations under the bonds, holding that "[a] promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity." *Id.*

This Court recognized and reaffirmed the principles of *Murray* in one of its most recent Contracts Clause cases. In *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977), New Jersey entered into a proprietary contract with bondholders by covenanting, through statute, to maintain the fiscal solvency of Port Authority of New York and New Jersey (the "Port Authority"). In exchange for assuming this financial obligation, New Jersey received the benefit of increasing "the public marketability of Port Authority bonds to finance construction of the World Trade Center and acquisition of the Hudson & Manhattan Railroad." *Id.* at 18. When New Jersey later repealed that statutory covenant with bondholders, this Court held that, because the contract at issue created a proprietary financial obligation, New Jersey could not use its sovereign powers to abrogate that obligation: "Whatever the propriety of a State's binding itself to a future course of conduct in other contexts, the power to enter into effective financial contracts cannot be questioned." *Id.* at 24.

Once again, this Court did not apply the unmistakability doctrine. To the contrary, it found that the New Jersey legislation violated the Contracts Clause even though the contract contained no express term barring such legislation. This Court reasoned that, under any other approach, every proprietary contract would be susceptible to impairment because "[a]ny financial obligation could be

regarded in theory as a relinquishment of the State's spending power, since money spent to repay debts is not available for other purposes. Similarly, the taxing power may have to be exercised if debts are to be repaid. Notwithstanding these effects, the Court has regularly held that the States are bound by their debt contracts." *Id.*[5]

Lower courts similarly have recognized that, where a state contracts in its proprietary capacity and not in its sovereign capacity, the unmistakability doctrine does not apply. *See Wright v. Dir., FEMA*, 913 F.2d 1566, 1570-71 (11th Cir. 1990) (holding that FEMA acted "much like any private insurance company" in administering an insurance program; thus, the insurance contracts were proprietary and "governed generally by the law applicable to contracts between private individuals" (quoting *Lynch*, 292 U.S. at 579)); *Continental-American Bank & Trust Co. v. United States*, 161 F.2d 935, 936 (5th Cir. 1947) (holding that, "when the United States becomes a party to commercial paper, it impliedly consents to be bound by the same rules governing private persons under the same circumstances" (quotations and citations omitted)); *United States v. First Nat'l Bank*, 131 F.2d 985, 987 (10th Cir. 1942) (same).

By contrast, when a party has contended that the government entered into the underlying contract in its sovereign capacity for the purpose of contracting away its sovereign powers, this Court has applied the unmistakability

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[5] *See also Wood*, 313 U.S. at 368-69 (the Contracts Clause prohibited Alabama from repealing a statute creating a contractual obligation for Alabama to honor its sale of property for nonpayment of taxes); *Louisiana ex rel. Hubert v. City of New Orleans*, 215 U.S. 170 (1909) (the Contracts Clause prohibited Louisiana from passing a statute prohibiting the payment of money owed pursuant to contracts entered into by municipalities with the police board pursuant to a delegation of authority from the state).

doctrine. For example, in *United States v. Cherokee Nation of Oklahoma*, 480 U.S. 700 (1987), an Indian tribe argued that the government had, by treaty, covenanted away its sovereign power to control navigable waters. Because this Court found the control of navigable waters to be "an aspect of sovereignty," it denied the claim based on the unmistakability doctrine. *Winstar*, 518 U.S. at 878 (describing *Cherokee Nation*, 480 U.S. at 707).

If the unmistakability doctrine had not been applied below, the Health Impact Fee indisputably would have been found to impair the settlement agreement. The settlement agreement "release[s] and forever discharge[s]" "any and all . . . liabilities of any nature whatsoever . . . whether legal, equitable or statutory ('Claims') that the State of Minnesota . . . ever had, now has or hereafter can, shall, or may have" "including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products." App., *infra*, 107a-108a. In direct contravention of the settlement agreement, the Health Impact Fee imposes liability on petitioners' released distributors "to recover for the state health costs related to or caused by tobacco use." Minn. Stat. § 256.9658(1). The two directly conflict. Thus, the Minnesota Supreme Court made clear that its decision to uphold the legislation was based solely on its application of the unmistakability doctrine to the settlement agreement. App., *infra*, 21a. Notably, the trial court, which did not apply the unmistakability doctrine, found that the Health Impact Fee impaired the contract.

II. THIS COURT SHOULD GRANT REVIEW TO RESOLVE CONFUSION AMONG THE LOWER COURTS REGARDING THE APPLICATION OF THE UNMISTAKABILITY DOCTRINE AND THIS COURT'S DECISION IN *WINSTAR*.

This Court should also grant review to clarify and to resolve the uncertainty among the lower courts concerning the meaning of *Winstar* and the application of the unmistakability doctrine. In *Winstar*, financial institutions claimed that the federal government breached its statutory covenant to allow them to use special accounting treatment after their acquisitions of failing thrifts. 518 U.S. at 858. The federal government raised the unmistakability doctrine, arguing that an agreement to maintain regulatory treatment would be a promise not to exercise a sovereign power, which must be made in unmistakable terms. *Id.* at 871. A plurality of this Court found that the unmistakability doctrine did not apply. *Id.* at 881.

The plurality opinion outlined a two-step inquiry for determining whether the unmistakability doctrine applies to a government contract. *Id.* at 880. The first step requires the court to determine whether the contract is "proprietary" or "sovereign" in nature. If the contract is proprietary, the unmistakability does not apply. Thus, the plurality stated that, when the government acts as a private party, or "contracts, say, to buy food for the army . . . no sovereign power is limited by the Government's promise to purchase and a claim for damages implies no such limitation. That is why no one would seriously contend that enforcement of humdrum supply contracts might be subject to the unmistakability doctrine." *Id.* Only if a state enters into the contract in its sovereign capacity should the court reach the second step -- determining whether the relief sought "would block [the] exercise of a sovereign power of the Government." *Id.* at 879 (emphasis removed).

The Minnesota Supreme Court ignored the first step of the plurality's analysis. Although the court acknowledged that "the unmistakability doctrine . . . never applies" to "humdrum supply" contracts, App., *infra*, 17a, the court nevertheless held that the doctrine applies to proprietary contracts if the act allegedly constituting a breach was a sovereign act. App., *infra*, 19a. The Minnesota court therefore jumped over the threshold issue of determining whether the State entered into a proprietary or sovereign contract and proceeded directly to the second issue. According to the Minnesota court, the doctrine applies even to proprietary contracts whenever the *relief* sought would "block [the] exercise of a sovereign power of the state." App., *infra*, 19a (emphasis removed).

If this interpretation of the unmistakability doctrine were accepted, it would eviscerate the protections of the Contracts Clause. The only relief afforded by the Contracts Clause is a declaration that the challenged legislation is a nullity. *See Winstar*, 518 U.S. at 887 n.32. Accordingly, the practical consequence of the Minnesota court's "leap frog" analysis is that a state may impair any proprietary contract at its whim -- provided it does so through legislation. This interpretation of *Winstar* directly conflicts with *Murray* and this Court's other Contracts Clause jurisprudence, including *United States Trust*, and writes the Contracts Clause out of existence.[6]

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[6] Even Justice Scalia's concurrence in *Winstar*, joined by Justices Kennedy and Thomas, is consistent with *Murray* and *United States Trust* and inconsistent with the decision below. While that concurrence would apply the unmistakability doctrine to a state's proprietary contracts, it would interpret the doctrine to have "little if any independent legal force beyond what would be dictated by *normal principles of contract interpretation*." *Id.* at 920 (Scalia, J., concurring in judgment) (emphasis added). Under Justice Scalia's analysis, a state does not, simply by virtue of its status as sovereign, reserve the right to alter a contract absent an

(Continued...)

Nor is the Minnesota court's misinterpretation of *Winstar* an aberration. At least two United States Circuit Courts of Appeals (the Third and Federal Circuits) likewise have read *Winstar* to mean that the unmistakability doctrine applies to all governmental contracts, even proprietary contracts, as long as the relief sought would block the exercise of a sovereign power. *See Tamarind Resort Assocs. v. Gov't of the Virgin Islands*, 138 F.3d 107, 109, 112 (3d Cir. 1998) (applying of the unmistakability doctrine even though the contract was "proprietary in nature"); *Yankee Atomic Elec. Co. v. United States*, 112 F.3d 1569, 1579 (Fed. Cir. 1997) (applying the unmistakability doctrine to uranium purchase contracts even while recognizing that "the contracts at issue . . . [we]re fixed-price contracts," and that normally "where one agrees to do, for a fixed sum, a thing possible to be performed, he will not . . . become entitled to additional compensation, because unforeseen difficulties are encountered" (internal quotation and citation omitted)). It is therefore imperative that this Court clarify that *Winstar* was not intended to eviscerate the Contracts Clause. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 241 (1978) (noting that the Contracts Clause was "perhaps the strongest single constitutional check on state legislation during our early years as a Nation," and noting the importance of courts recognizing that it "remains part of the Constitution" and "is not a dead letter").

The decision below also deepens the confusion and uncertainties among the lower courts regarding the proper interpretation of *Winstar*. This confusion is real and well-

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unmistakable promise to the contrary. The Minnesota Supreme Court's holding that the doctrine applied to all government contracts and required a second promise not to breach a proprietary contract was advocated only by the two *Winstar* dissenters. *See id.* at 924-26 (Rehnquist, C.J., dissenting, joined in part by Ginsburg, J.).

recognized by the lower courts themselves. *See, e.g.*, *Tamarind Resort Assocs.*, 138 F.3d at 112 ("It is somewhat unclear after the *Winstar* plurality opinion as to the type of contract to which the unmistakability doctrine applies."); *Rio Grande Silvery Minnow v. Keys*, 333 F.3d 1109, 1139-40 (10th Cir. 2003) (Seymour, J., concurring) ("Given the various opinions in *Winstar*, none of which commanded a majority, it is clear that not all contracts to which the government is a party are subject to the unmistakable terms doctrine," but "the fractured Winstar decision leaves us with some uncertainty regarding the extent and applicability of the unmistakable terms doctrine in specific situations.") (internal quotations omitted), *opinion vacated by* 355 F.3d 1215 (10th Cir. 2004).[7]

Academic commentators have likewise noted the confusion surrounding *Winstar*. *See, e.g.*, Joshua I. Schwartz, *The Status of the Sovereign Acts and Unmistakability Doctrines in the Wake of Winstar: An Interim Report*, 51 Ala. L. Rev. 1177, 1183 (2000) (reviewing post-*Winstar* cases and

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[7] *See also United States v. Wetlands Water Dist.*, 134 F. Supp. 2d 1111, 1146-48 (E.D. Cal. 2001) ("Although seven Justices formed the majority to support the *Winstar* unmistakability judgment (*i.e.* that it did not shield the government from liability), there was not a majority opinion, and the four separate opinions are thoroughly fragmented, not articulating any unified analysis in support of the judgment based on either the unmistakability or sovereign acts doctrines. . . . As a result of these shifting positions, it appears particularly problematic to predict which unmistakability standard applies to any specific contract."); *Gen. Dynamics Corp. v. United States*, 47 Fed. Cl. 514, 540 n.9 (2000) (noting that commentators have described *Winstar* as a "delphic puzzle"); *Adams v. United States*, 42 Fed. Cl. 463, 482-83 (1998) ("[T]he applicability of the unmistakability doctrine to particular cases after *Winstar* is unclear. . . . [T]his court, and, undoubtedly, many others would welcome further clarification."); *Pitney Bowes, Inc. v. United States Postal Serv.*, 27 F. Supp. 2d 15, 23 (D.D.C. 1998) ("Courts have struggled with the meaning of *Winstar*.").

noting that the lowers courts have struggled to "make a sensible and coherent whole out of the unruly strands of law left" after *Winstar*); Alan R. Burch, *Purchasing the Right to Govern: Winstar and the Need to Reconceptualize the Law of Regulatory Agreements*, 88 Ky. L.J. 245, 251 (2000) (commenting that "*Winstar* throws nearby areas of the law into confusion"); Michael W. Graf, *The Determination of Property Rights in Public Contracts After Winstar v. United States: Where Has the Supreme Court Left Us?*, 38 Nat. Resources J. 197, 225 (1998) (Because the "Court's main opinion does not discuss how the unmistakability doctrine should be applied in resolving government contract disputes," there is "confusion regarding the proper role of the doctrine.").

The stakes at issue here are high; application of the unmistakability doctrine to proprietary contracts "would place the doctrine at odds with the Government's own long-run interest as a reliable contracting partner." *Winstar*, 518 U.S. at 883:

> From a practical standpoint, it would make an inroad on this power, by expanding the Government's opportunities for contractual abrogation, with the certain result of undermining the Government's credibility at the bargaining table and increasing the cost of its engagements. As Justice Brandeis recognized, "[p]unctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors." *Lynch*, 292 U.S. at 580.

Id. at 884-85. As Justice Breyer observed in his concurrence in *Winstar*, for over 100 years, "in practical terms [the Court's jurisprudence] [has] ensure[d] that the government is able to obtain needed goods and services from parties who might otherwise, quite rightly, be unwilling to undertake the risk of government contracting." *Id.* at 913 (Breyer, J., concurring)

(citing *Detroit v. Detroit Citizens' St. Ry. Co.*, 184 U.S. 368, 384 (1902); *Murray*, 96 U.S. at 445; *New Jersey v. Yard*, 95 U.S. 104, 116-117 (1877)). The Minnesota decision conflicts with this policy and, if allowed to stand, would cause those who would enter into contracts with the government to no longer have the assurance that the states would be bound by those contracts.[8]

In sum, this case presents an excellent vehicle to clarify *Winstar* and, in particular, the application of the unmistakability doctrine to proprietary contracts. For all these reasons, this Court should grant the petition.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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[8] The Minnesota court's decision would likewise undermine ability of the states' agencies and political subdivisions to act as a "reliable contracting partner[s]." *See, e.g.*, *Murray*, 96 U.S. at 445 (applying the Contracts Clause to invalidate a city's impairing ordinance).

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November 3, 2006

APPENDIX

APPENDIX A -- OPINION OF THE MINNESOTA SUPREME COURT DATED MAY 16, 2006

STATE OF MINNESOTA

IN SUPREME COURT

A05-2540

Ramsey County

Anderson, Russell A., C.J.

Concurring specially, Page, J.

Took no part, Hanson, J.

Filed: May 16, 2006

The State of Minnesota, by Hubert H. Humphrey, III, its then Attorney General,

Appellant,

Blue Cross and Blue Shield of Minnesota,

Plaintiff,

vs.

Philip Morris USA, Inc.,

Respondent,

R.J. Reynolds Tobacco Company, et al.,

Respondents,

Brown & Williamson Tobacco Corporation, et al.,

Defendants,

A.H. Hermel Candy & Tobacco Co., et al., intervenors,

Respondents,

Council of Independent Tobacco Manufacturers of America, intervenor,

Respondent,

Commonwealth Brands, Inc., intervenor,

Respondent.

SYLLABUS

The imposition of the Health Impact Fee under Minn. Stat. § 256.9658 (Supp. 2005) does not violate the 1998 settlement agreement between respondent tobacco companies and the state because the terms of the settlement agreement do not unmistakably relinquish the state legislature's sovereign authority to impose such an exaction on tobacco products in order to recover health care costs related to the use of tobacco products and to discourage smoking.

Reversed.

Heard, considered, and decided by the court en banc.

OPINION

ANDERSON, Russell A., Chief Justice.

We are asked to determine whether the appellant State of Minnesota can impose a 75-cent Health Impact Fee on the cigarettes of manufacturers that are parties to the 1998 settlement of the state's tobacco suit, *State by Humphrey v. Philip Morris USA, Inc.*, No. C1-94-8565 (Ramsey Cty. Dist Ct.). Respondents Philip Morris USA, Inc., R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company, Inc., challenge the imposition of the fee on their products. The Ramsey County District Court concluded that the Health Impact Fee violates the settlement agreement and is unconstitutional. The district court also concluded that if the Health Impact Fee cannot be imposed on respondents' products, continued imposition of the Health Impact Fee on the products of the intervenors, a cigarette manufacturer and an industry trade association of cigarette manufacturers that are not parties to the settlement agreement, would constitute selective enforcement and violate those intervenors' right to equal protection. We granted accelerated review and now reverse the district court. We conclude that the imposition of

the Health Impact Fee does not violate the settlement agreement because the terms of the settlement agreement do not unmistakably relinquish the state legislature's sovereign authority to impose such an exaction on tobacco products in order to recover health care costs related to the use of tobacco products and to discourage smoking.

In 1994, the state and co-plaintiff Blue Cross and Blue Shield of Minnesota sued certain major cigarette manufacturers and trade organizations, asserting claims for monetary, equitable, and injunctive relief. The state settled with one of the defendant manufacturers, Liggett Group, Inc., in 1997, and in May 1998 settled with the remaining defendants (settlement agreement). The terms of the settlement agreement required the manufacturers to make six payments to the state of specified amounts through January 2003, as well as additional annual payments to the state beginning on December 31, 1998, and continuing in perpetuity. The settlement agreement provided that each of the payments to the state were in satisfaction of the state's claim for damages incurred in the year of such payment or earlier years "relat[ing] to the subject matter of this action." The settlement agreement also included mutual releases and a covenant not to sue by the state. In addition, the terms of the settlement required the settling manufacturers to restrict their advertising, lobbying, and litigation activities. The Ramsey County District Court retained jurisdiction to enforce the settlement agreement.

In July 2005, the legislature enacted legislation imposing a "Health Impact Fee" of 75 cents on each pack of cigarettes sold in Minnesota after July 31, 2005. Act of July 14, 2005, ch. 4, art. 4, § 2, 2005 Minn. Laws 1st Spec. Sess. 2454, 2541-42 (codified at Minn. Stat. § 256.9658 (Supp. 2005)). The legislature expressly stated that the purposes of the Health Impact Fee were "to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths." Minn. Stat. § 256.9658, subd. 1. The Health Impact Fee "is imposed on and collected

from" cigarette distributors. *Id.* Cigarette distributors pay the fee "at the same time and in the same manner" as they pay cigarette taxes under Minn. Stat. ch. 297F (2004 & Supp. 2005), that is, by purchase of a tax stamp that must be affixed to each pack of cigarettes. Minn. Stat. § 256.9658, subds. 4, 7. In the same legislation, the legislature amended the Unfair Cigarette Sales Act to specifically include "fees," such as the Health Impact Fee, in the definition of the "basic cost of cigarettes." Act of July 14, 2005, ch. 4, art. 4, § 4, 2005 Minn. Laws 1st Spec. Sess. at 2543 (codified as amended at Minn. Stat. § 325D.32, subd. 9 (Supp. 2005)); *see* Minn. Stat. § 325D.31 (2004).

Finally, the legislation also created a Health Impact Fund in the state treasury, to which revenue from the Health Impact Fee is credited. Act of July 14, 2005, ch. 4, art. 4, § 1, 2005 Minn. Laws 1st Spec. Sess. at 2541 (codified at Minn. Stat. § 16A.725 (Supp. 2005)). The Commissioner of Human Services is required to certify annually the health care costs incurred by the state for the previous fiscal year attributable to tobacco use, and the Commissioner of Finance must transfer funds from the Health Impact Fund to the general fund to offset those certified health care expenditures. Minn. Stat. § 16A.725, subds. 2, 3(a).

In August 2005, Philip Morris USA, R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company (collectively the "settling manufacturers") and their distributors[1] filed motions in Ramsey County District Court

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[1] The following distributors of the settling manufacturers' products are also respondents in this appeal: A.H. Hermel Candy & Tobacco Co.; Henry's Foods, Inc.; Sandstrom's Inc.; Johnson Candy and Tobacco Co. of Brainerd, Inc.; M. Amundson Cigar & Candy Company LLP; The Watson Companies, Inc.; Granite City Jobbing Company, Inc.; Minter-Weisman Co.; Segal Wholesale, Inc.; and Tyler Wholesale, Inc.

Unless otherwise qualified, references in this opinion to respondents mean the settling manufacturers and these distributors.

under the caption of the 1994 tobacco case seeking to enforce the terms of the settlement agreement and to prevent the imposition of the Health Impact Fee on their products. The respondents alleged that the state's release in the settlement agreement "serves as a complete bar and defense to any attempt by the State to collect the [Health Impact Fee] with respect" to their products. Commonwealth Brands, Inc., a cigarette manufacturer that was not a party to the state's tobacco litigation, intervened, as did the Council of Independent Tobacco Manufacturers of America, whose cigarette manufacturer members also were not parties to the state's tobacco litigation. The intervenors alleged that, if the court ruled the Health Impact Fee could not be imposed on the products of the settling manufacturers, it could not be imposed on the intervenors' products[2] without violating the intervenors' rights under the First Amendment and the Equal Protection Clause of the U.S. Constitution, as well as the Uniformity Clause of the state constitution. Governor Tim Pawlenty, by his counsel, participated as an amicus curiae.

By order dated December 20, 2005, the Ramsey County District Court granted the respondents' motion to enforce the settlement agreement, ordering that "the Health Impact Fee violates the Settlement Agreement and is unconstitutional." The court noted that the "essential benefits" of the settlement agreement to respondents were that it "reduced to liquidated form, those damages which the state sought to collect by its lawsuit." The court also noted that by enacting the Health Impact Fee the legislature sought "to recover those costs from the settling defendants which are prohibited by the settlement agreement." The court stated

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[2] Although intervenor Council of Independent Tobacco Manufacturers of America manufactures no products, its members do. For ease of reference, we will refer to the products of those member manufacturers and of intervenor Commonwealth Brands as intervenors' products.

that by seeking reimbursement of tobacco-related health care costs the state had violated the settlement agreement.

The district court also granted the intervenors' motion to bar the imposition of the Health Impact Fee on their products, ordering that "the Health Impact Fee cannot be enforced against [the intervenors] because it constitutes a selective enforcement and deprives them of equal protection under the law." Having barred the imposition of the Health Impact Fee on the products of the settling manufacturers, the court noted that imposing the Health Impact Fee on other cigarettes would give the settling manufacturers' products "a distinct marketplace advantage in price" that would only encourage underage smokers to switch to those products, rather than to quit altogether. As a result, the district court stated, the purposes of the legislation—to recover tobacco-related health care costs and discourage smoking—would not be met if the Health Impact Fee were imposed on only some cigarettes.

Finally, the district court ordered that "[t]he defendants and the intervenors are [entitled] to credit or refunds, to the extent paid." The court stayed its order pending appeal, and the state continues to collect the Health Impact Fee. However, the state must keep any funds collected in the Health Impact Fund until all appeals are exhausted and the district court has determined how those funds will be disbursed.

By order dated January 19, 2006, we granted the state's petition for accelerated review and set an expedited schedule for briefing and oral argument.

I.

Because the facts are undisputed, the only issues before us on appeal from the district court's order enforcing the settlement agreement are questions of contractual, statutory, and constitutional interpretation. These are legal issues subject to de novo review. *See, e.g., Employers Mut.*

Cas. Co. v. A.C.C.T., Inc., 580 N.W.2d 490, 493 (Minn. 1998) (contract interpretation); *Vlahos v. R & I Constr. of Bloomington, Inc.*, 676 N.W.2d 672, 679 (Minn. 2004) (statutory interpretation); *State v. Brooks*, 604 N.W.2d 345, 348 (Minn. 2000) (constitutional interpretation).

We consider the settlement agreement as a contract. *Ryan v. Ryan*, 193 N.W.2d 295, 297 (Minn. 1971). Unambiguous language in the settlement agreement is to be given its plain and ordinary meaning. *See Minneapolis Pub. Hous. Auth. v. Lor*, 591 N.W.2d 700, 704 (Minn. 1999). In construing ambiguous contract language, we consider the contract as a whole in light of the circumstances surrounding its formation, and strive to arrive at the parties' real understanding. *See Donnay v. Boulware*, 275 Minn. 37, 43, 144 N.W.2d 711, 715 (1966).

Respondents and intervenors also urge us to declare the Health Impact Fee unconstitutional. We will uphold a statute unless the challenging party demonstrates that it is unconstitutional beyond a reasonable doubt, and every presumption is invoked in favor of the constitutionality of a statute. *E.g., Hutchinson Tech., Inc. v. Comm'r of Revenue*, 698 N.W.2d 1, 14 (Minn. 2005). Moreover, we do not reach constitutional issues if the matter can be resolved otherwise. *In re Senty-Haugen*, 583 N.W.2d 266, 269 n.3 (Minn. 1998) (citing *Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 346-48 (1936) (Brandeis, J., concurring)). Accordingly, we first evaluate the parties' arguments as to the construction of the settlement agreement.

II.

There is no dispute that in the settlement agreement the state agreed to release respondents from a range of potential future claims in return for the required settlement payments and restrictions on future conduct. We must decide whether any obligations created by the Health Impact Fee legislation are within the scope of those released. To do this, we first examine the nature of the obligations the Health

Impact Fee legislation imposed on respondents. Second, we look to the settlement agreement to determine, as a matter of contract interpretation, whether Health Impact Fee obligations are among those the state released.

A.

We first consider what obligations, if any, the enactment of the Health Impact Fee imposed on respondents. As we have noted, Minn. Stat. § 256.9658 imposes a Health Impact Fee of 75 cents on each pack of cigarettes sold in Minnesota after July 31, 2005. *See* Act of July 14, 2005, ch. 4, art. 4, § 2, 2005 Minn. Laws 1st Spec. Sess. at 2541-42. Minnesota Statutes § 256.9658, subd. 4, requires that cigarette distributors pay the Health Impact Fee to the state "at the same time and in the same manner as provided for payment of tax under chapter 297F." Minnesota Statutes §§ 297F.08-.09 (2004 & Supp. 2005), in turn, require that cigarette distributors remit cigarette taxes and fees to the state by purchasing tax stamps, which are then affixed to each pack of cigarettes sold in the state.

The Minnesota Unfair Cigarette Sales Act, Minn. Stat. §§ 325D.30-.42 (2004 & Supp. 2005), establishes a minimum price (called the "basic cost") for cigarettes. As amended by the Health Impact Fee legislation, that minimum price includes all taxes *and fees* imposed by the state, including the Health Impact Fee. *See* Minn. Stat. § 325D.32, subd. 9 (Supp. 2005). Further, the Unfair Cigarette Sales Act requires both distributors and retailers to charge at least the "basic cost" (plus a statutorily-presumed cost of doing business markup) for the cigarettes they sell. Minn. Stat. § 325D.33, subd. 1 (2004) (prohibiting wholesalers and retailers from selling cigarettes at less than their respective costs); Minn. Stat. § 325D.32, subds. 10, 11 (2004) (defining "cost to wholesaler" and "cost of the retailer" to mean the "basic cost" of cigarettes plus their respective "cost of doing business"). Thus, distributors are required by law to pass the Health Impact Fee through to cigarette retailers, and retailers are

required to pass the Health Impact Fee through to retail cigarette purchasers. As a result, Minnesota law requires that retail cigarette purchasers, not cigarette manufacturers or distributors, bear the economic burden of the Health Impact Fee.

In enacting the Health Impact Fee and thereby increasing the cost of a tax stamp, the legislature did create an obligation on the part of cigarette distributors, to remit the fee to the state through their purchase of tax stamps. Therefore, the district court correctly stated that the Health Impact Fee is "collected from the distributors of tobacco products." But the distributors ultimately bear no economic burden from the imposition of the Health Impact Fee because it must be passed on to retail purchasers, including a markup for the distributors' cost of doing business. On the other hand, the legislation imposed no liabilities, obligations, or claims on cigarette manufacturers for the Health Impact Fee. The only impact of passage of the Health Impact Fee on the manufacturers is that *others*, ultimately consumers, are required to pay the fee when the manufacturers' products are sold.

Thus, while one of the express purposes of the Health Impact Fee legislation was to recover tobacco-related health care costs for the state, those costs are not recovered from respondents. The law requires retail cigarette consumers to bear the cost of the Health Impact Fee, and it is therefore those consumers who in fact reimburse the state for health care costs associated with tobacco use.

B.

We next address whether the obligations imposed by the enactment of the Health Impact Fee are within the scope of the release agreed to by the state in the settlement agreement. In doing so, it is helpful to consider a more complete presentation of the language of the state's release, rather than partial excerpts:

> State of Minnesota's Release and Discharge. Upon Final Approval, the State of Minnesota shall release and forever discharge all Defendants [and specified related entities, including distributors] from any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims") that the State of Minnesota [and its related entities] whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:
>
> a. for past conduct, as to any Claims relating to the subject matter of this action which have been asserted or could be asserted now or in the future in this action or a comparable Federal action by the State; and
>
> b. for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

Despite the fact that respondents are not obligated to pay the Health Impact Fee themselves, they argue that the imposition of the fee violates the settlement agreement. In doing so, respondents do not acknowledge the specific and limited obligations placed upon them by the Health Impact

Fee legislation, but focus on the legislation's purpose, to recover tobacco-related health care costs, regardless of who pays. Therefore, we begin our analysis with the nature of the claims, as respondents construe them, that respondents contend the state released and that respondents contend are improperly revived by the Health Impact Fee legislation.

Respondents argue that the terms of the settlement agreement create "a broad, comprehensive 'Release and Discharge' of all claims by the State—past, present, and future—for reimbursement of health care costs attributable to tobacco." Respondents assert that this broad release of all claims for recovery of health care costs was the "only tangible benefit" they received under the settlement agreement. Although respondents do not articulate the boundaries of this release with specificity, there appear to be two important characteristics of the release as construed by respondents.

First, as noted above, in respondents' view the state's broad release of claims for reimbursement of health care costs is not limited to reimbursement by respondents. For if the release is limited to reimbursement *by respondents* for health care costs, the Health Impact Fee would not fall within the release at all, because the manufacturers are not required to pay any part of the fee and their distributors are reimbursed for their initial payment of the fee through retail sales.

Second, respondents contend that the release of claims for reimbursement of health care costs extends beyond claims that may be brought in litigation to actions by the legislature to recover those costs. Respondents state that a general excise tax on tobacco products would not be subject to the release, even if its proceeds were used to pay for tobacco-related health care costs. But they argue that a legislative revenue measure that is expressly intended to recover health care costs *would* fall within the scope of the released claims. The distinction, apparently, is the legislation's express focus on recovery of health care costs.

In positing this release of all claims for reimbursement of health care costs, respondents rely on both the broad language of the release that relieves them of "liabilities of any nature whatsoever, * * * whether legal, equitable or statutory," and on the specific reference in subparagraph b of the release to "any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products." They also point to the provision earlier in the settlement agreement that each annual payment is "in satisfaction of all of the State of Minnesota's claims for damages incurred by the State in the year of such payment or earlier years * * * including, without limitation * * * claims for [tobacco-related] health care expenditures." Moreover, because the release includes "statutory" claims, respondents assert, it necessarily includes revenue measures enacted by the legislature.

Thus, again, respondents' contention is that in the settlement agreement the state released all claims for future recovery of tobacco-related health care costs, including revenue measures enacted by the legislature if they are expressly intended to recover those costs. Because the Health Impact Fee is expressly aimed at recovering tobacco-related health care costs, respondents conclude, it cannot be enforced against them, or, apparently, their products.

The district court similarly focused on recovery of health care costs. It concluded that the imposition of the Health Impact Fee "seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement." Although like respondents' argument the district court's memorandum is also lacking in some specificity, by "those costs," we assume the court meant "state health costs related to or caused by tobacco use," referenced in the court's preceding paragraph. In fact, the essence of the court's conclusion that the imposition of the Health Impact Fee violates the settlement agreement seems to be that the purpose of the Health Impact Fee legislation "was to seek government reimbursement for the costs associated with tobacco,"

because the court stated "[t]hat the state sought reimbursement of tobacco-related health care costs clearly violates the Settlement Agreement."

The state counters that the settlement agreement was not intended, as respondents insist, to restrict future legislative acts. According to the state, the purpose of the settlement agreement was to resolve only adjudicatory claims, such as those asserted by the state in its lawsuit. Arguing that the state participated in the settlement agreement only in its proprietary, rather than its sovereign, capacity, the state contends that the release of future claims based on respondents' future conduct meant only that the state released claims, obligations, or liabilities it could attempt to establish through future litigation, including any claims for recovery of tobacco-related health care costs. In other words, the state says it gave up the right to sue respondents in the future to recover damages, including health care costs, from future wrongful conduct of respondents. The reference to "statutory" claims or liabilities in the release, the state asserts, was to legislatively-created claims for relief that it could assert in future lawsuits, such as consumer fraud actions. The state contends the settlement agreement did not, and could not, release respondents from future regulation by the legislature, including future financial obligations the legislature might impose on the tobacco industry generally.[3]

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[3] The state also contests respondents' assertion that the only tangible value of the settlement was a broad release of claims for future smoking-related health care costs. Rather, the state argues, significant other benefits inured to respondents, even under a more narrow reading of the release. For example, respondent manufacturers were relieved of the uncertainty of a possible adverse verdict, which could have resulted in awards of compensatory and punitive damages greater than the agreed-to settlement amounts and which could potentially have been used against respondent manufacturers in similar litigation then pending around the country. Additionally, the state asserts the release of future claims freed respondent manufacturers from the potential of

(Continued...)

The state argues further that if the settlement agreement were construed broadly to bar future legislative action that imposes financial obligations on respondents' products merely because the proceeds are earmarked for payment of future health care costs, the agreement would constitute a surrender of sovereign legislative authority, particularly the taxing and police powers.[4] The state contends that under the "unmistakability doctrine," a contract cannot be construed to waive or surrender a sovereign power of the state unless the contract does so in unmistakable language, which, the state further asserts, is not to be found in the settlement agreement.

As explained in more detail below, we conclude that to construe the settlement agreement as respondents urge, that is, to waive the legislature's authority to enact revenue measures to recover tobacco-related health care costs, would be a surrender of the legislature's sovereign power. As a result, the unmistakability doctrine applies and requires that we not so construe the settlement agreement unless it surrenders sovereign power in unmistakable terms. We do not find the requisite unequivocal language in the settlement agreement, and therefore conclude that the Health Impact Fee legislation does not violate the terms of the agreement.

The unmistakability doctrine is a rule of contract construction that provides the sovereign powers of a state

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further litigation seeking to recover future damages, including, but not limited to, future health care costs. We agree that these benefits of the settlement agreement are both tangible and significant.

[4] The parties disagree whether the Health Impact Fee is a tax or a fee. We need not resolve that dispute because, whether the Health Impact Fee is a tax enacted under the taxing power or a regulatory fee enacted under the police power, it is undisputedly an exercise of a sovereign power of the legislature.

cannot be contracted away except in "unmistakable" terms. The United States Supreme Court's recent explanation of the historical underpinnings of the unmistakability doctrine is helpful in appreciating the purposes and application of the doctrine. *See United States v. Winstar Corp.*, 518 U.S. 839, 871-79 (1996) (plurality opinion). The plurality in *Winstar* explained that the unmistakability doctrine was developed in early cases applying the Contract Clause of the U.S. Constitution to state contracts. *Winstar*, 518 U.S. at 874. "Although that Clause made it possible for state legislatures to bind their successors by entering into contracts, it soon became apparent that such contracts could become a threat to the sovereign responsibilities of state governments." *Id.* As the *Winstar* plurality explained, two limitations developed to protect state regulatory powers: the "reserved powers" doctrine, under which certain sovereign powers of the state could not be contracted away, and the "unmistakability" doctrine, a canon of construction under which "neither the right of taxation, nor any other power of sovereignty, will be held * * * to have been surrendered, unless such surrender has been expressed in terms too plain to be mistaken." *Id.* at 874-75 (citation and internal quotation marks omitted). Summarizing recent applications of the unmistakability doctrine, the plurality explained that neither silence nor ambiguous terms in a contract will be construed as effecting a waiver of sovereign authority. *Id.* at 878 ("[A] contract with a sovereign government will not be read to include an unstated term exempting the other contracting party from the application of a subsequent sovereign act * * *, nor will an ambiguous term of a * * * contract be construed as a conveyance or surrender of sovereign power."); *see also Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 52 (1986).

Although not using the phrase "unmistakability doctrine," we explained the same principles as early as 1908. In *State v. Great Northern Railway Co.*, a railroad challenged legislation increasing the rate of taxation on it on the basis

that the railroad had been guaranteed a lower tax rate by the railroad's state charter. 119 N.W. 202, 203-05 (Minn. 1908), *aff'd*, 216 U.S. 206 (1910). Although at the time the charter had been granted the legislature was free to limit its power of taxation by contract, we explained that the power of taxation was a sovereign prerogative and therefore a contractual limitation on that power should not be found based on inferences or ambiguous language. *See id.* at 205. Rather, a contract purporting to limit the state's right to tax in the future "is to be strictly construed, and must be in language and terms too clear to admit of doubt." *Id.* at 205 (citing *Chicago, Burlington & Kan. City R.R. v. Guffey*, 120 U.S. 569 (1887)).

Respondents argue that the unmistakability doctrine does not apply here because the settlement agreement infringed neither the taxation power nor the police power. Instead, respondents argue that in the settlement agreement the state simply assumed the risk that "it would not be able to impose new liabilities for the State's smoking-attributable health care costs beyond the liability created by the Settlement Agreement." Respondents contend such "risk-shifting" does not affect sovereign powers and does not, therefore, trigger the unmistakability doctrine. Respondents rely on the plurality opinion in *Winstar*, 518 U.S. at 880, for this risk-shifting argument. But respondents' argument misapplies the concept discussed in that case.

The plurality in *Winstar* explained that the application of the unmistakability doctrine differs according to the type of obligations assumed by the government and the consequences of enforcing them.[5] 518 U.S. at 880. At one end of the

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[5] Because it is necessary to examine not only the nature of the government's obligation, but also the consequences of enforcing the obligation, respondents' argument that the unmistakability doctrine is inapplicable simply because the settlement agreement was entered into by the state in its proprietary capacity does not adequately address the issue.

spectrum are obligations to which the unmistakability doctrine always applies, that is, "claims for enforcement of contractual obligations that could not be recognized without effectively limiting sovereign authority," such as a claim for a tax rebate based on an agreement for a tax exemption. *Id.* Because granting a tax rebate would essentially negate the exercise of the taxing power, the unmistakability doctrine would have to be satisfied, according to the plurality. *Id.* At the other end of the spectrum are ordinary contracts, such as "humdrum supply contracts," where sovereign power is not compromised by enforcement of the promise made, and the unmistakability doctrine therefore never applies. *Id.* In between these poles, the plurality stated, there are an "enormous variety" of contracts under which performance may or may not involve the exercise or the forbearance of a sovereign power. *Id.* As to these contracts, the plurality said:

> So long as such a contract is reasonably construed to include a risk-shifting component *that may be enforced without effectively barring the exercise of that [sovereign] power*, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to guard against, and there is no reason to apply it.

Id. (emphasis added).

Applying these principles in *Winstar*, the plurality found the unmistakability doctrine inapplicable because the plaintiffs did not claim the contracts, which promised application of a specific regulatory accounting practice to them, barred enforcement of changed regulatory requirements adopted by the government agency. *See id.* at 881, 887. Rather, the plaintiffs asserted only that the government was required to pay damages as a result of its failure to maintain the previous regulatory structure as to plaintiffs, as it had promised. *Id.* at 871. Moreover, the damages sought by the plaintiffs would not effectively negate the exercise of

sovereign power in changing the regulatory requirements by depriving the government of money it would otherwise have been entitled to receive, as would a tax rebate. *See id.* at 882-83.

Here, in asserting that the settlement agreement resulted only in risk-shifting, respondents explain that risk-shifting as follows: "[T]he State assumed the risk that future legislation would create additional 'liabilities of any nature whatsoever' that would fall within the Release *and thus be unenforceable* as to the Settling Defendants' products." (Emphasis added.) Thus, in contrast to the plaintiffs in *Winstar*, respondents argue that the consequence of the promise made by the state is that the exercise of sovereign power by the legislature is *unenforceable* as to them and their products. In other words, respondents do not posit a "risk-shifting component that may be enforced without effectively barring the exercise of that [sovereign] power." *Winstar*, 518 U.S. at 880. Rather, the very relief respondents seek requires the state either to exempt respondents from the exercise of the state's sovereign powers to tax and to regulate, or to surrender those powers with respect to the cigarette industry altogether. Therefore, contrary to respondents' argument, even the risk-shifting analysis of the plurality in *Winstar* requires application of the unmistakability doctrine in the circumstances of this case.

The district court did not rely on the risk-shifting theory, but nevertheless declined to apply the unmistakability doctrine, finding that the settlement agreement "involves neither the eradication [n]or usurpation of [the state's] sovereign power but its assent to a contract, of the nature and type, which the state enters into every day in a variety of situations." If by this reference to "everyday" contracts the court meant that the settlement agreement falls into the category the plurality in *Winstar* described as "humdrum supply contracts," as to which sovereign power is not compromised by enforcement of the promise made, we cannot agree. Rather, as construed by the court and

advocated by respondents, the release in the settlement agreement purports to bar the future exercise of the sovereign police powers of the state. It is in this respect that the settlement agreement implicates the unmistakability doctrine.

The district court's conclusion that the release did not infringe on sovereign powers may also be based on its conclusion that the release would not bar the imposition of a tax on respondents' products. The court found that the Health Impact Fee is a "fee," not a tax, and concluded the legislature's imposition of a "fee" is barred by the state's release, although a "tax" would not be barred. It appears that respondents agree, conceding that a "general excise tax" imposed on tobacco products would not be contrary to the release. But respondents contend a revenue measure expressly earmarked to fund tobacco-related health care costs is barred, regardless of whether it is considered a tax or a fee. In terms of applicability of the unmistakability doctrine, however, neither the label "tax" or "fee" nor the specification or lack thereof for spending the funds so generated is relevant. Either way, the revenue measure would be an exercise of the legislature's sovereign power, and, if enforcement of the contractual obligation alleged would block exercise of *a* sovereign power of the state, it matters not whether the particular power negated is the taxing power or the police power.[6]

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[6] The state argues that under Minn. Const. art. X, § 1, the taxing power cannot be contracted away, even in unmistakable terms. Article X, section 1, which was enacted after the grant of the railroad charter at issue in the *Great Northern Railway* decision, provides that "[t]he power of taxation shall never be surrendered, suspended or contracted away." This argument would apply if the Health Impact Fee were a tax, but we need not decide that issue, because our resolution of the case under the unmistakability doctrine does not turn on whether it is a fee or a tax.

The Supreme Court has noted that the unmistakability doctrine serves "the dual purposes of limiting contractual incursions on a State's sovereign

(Continued...)

We therefore conclude that we must apply the unmistakability doctrine in assessing whether, as respondents argue, the settlement agreement effectuated a broad waiver of future claims that includes legislative enactments to recover tobacco-related health care costs. We must examine the language of the settlement agreement to determine not just whether it supports a waiver of the legislature's power to enact future revenue measures expressly intended to address the costs of tobacco-related health care, but whether it does so in unmistakable terms. We turn now to that task.

In doing so, we are guided by the principles of construction stated in *Great Northern Railway* and *Winstar*. We are not to draw inferences from indefinite language or make presumptions from uncertain language. *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205; *Winstar*, 518 U.S. at 874. Rather, the settlement agreement is to be strictly construed, and any waiver of sovereign power must be "in language and terms too clear to admit of doubt." *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205; *see also Winstar*, 518 U.S. at 874.

Respondents argue that the language of the settlement agreement is sufficiently clear to satisfy the unmistakability doctrine. In particular, respondents argue that the phrase "liabilities of any nature whatsoever" is unequivocally as broad as can be, and the specific reference to "statutory" liabilities and claims makes it clear that legislatively-created liabilities and claims are included in the release. Finally,

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powers and of avoiding difficult constitutional questions about the extent of State authority to limit the subsequent exercise of legislative power." *Winstar*, 518 U.S. at 875. It serves both of those salutary purposes here as well, also rendering unnecessary rulings on the parties' additional arguments about the scope of the attorney general's authority to bind the state legislature and whether the legislature ratified the settlement agreement.

respondents point to the language in the settlement agreement that references "any future claims for reimbursement for health care costs allegedly associated with use or exposure to Tobacco Products" as clearly defining the waiver in terms of those specific costs.

We disagree. Application of the unmistakability doctrine compels the conclusion that the settlement agreement cannot be construed to waive the legislature's sovereign authority under the tax and police powers to enact revenue measures, even if earmarked for payment of tobacco-related health care costs. We cannot say that the language of the settlement agreement effects such a waiver of the state's sovereign powers in language "too clear to admit of doubt." *Great N. Ry. Co.*, 119 N.W. at 205. Although the phrase "liabilities of any nature whatsoever" is broad, it is insufficiently specific to meet the requirements of the unmistakability doctrine. The language mentions neither the police nor the taxing power. Nor does the language expressly waive the state's right to impose future taxes or fees on respondents or their products, or expressly waive the state's right to further regulate the cigarette industry in the future.

Moreover, we cannot help but note that the phrase "liabilities of any nature whatsoever" (or similar language) is commonly used in general release forms in disputes having nothing to do with any state sovereign power. Where the language of a contract is argued to surrender sovereign powers of the state, we believe the unmistakability doctrine and the principles on which it is premised require more particularized identification of the waiver intended than is conveyed by boilerplate release language. Accordingly, we construe the settlement agreement not to bar enforcement of the Health Impact Fee.

Our conclusion is buttressed by the fact that key provisions of the settlement agreement are more consistent with the narrower interpretation of the scope of the claims

released that is advocated by the state than with the broad waiver of legislative authority advanced by respondents.

One such provision is the clause that defines the claims that are satisfied by the payments respondent manufacturers make each year under the settlement agreement. The clause provides that such payments to the state:

> are in satisfaction of all of the State of Minnesota's claims for damages incurred by the State in the year of such payment or earlier years *related to the subject matter of this action*, including, without limitation, claims for equitable and injunctive relief, *claims for health care expenditures* and claims for punitive damages.

(Emphasis added.) The satisfaction of claims clearly includes claims for health care expenditures, but it equally clearly is limited to the subject matter of the tobacco litigation. This supports the state's view that even the future payments to be made under the settlement agreement resolve only claims the state could pursue through litigation.

In addition, although the release provision broadly defines the term "claim," using among other language the phrase "liabilities of any nature whatsoever," this "claim" definition is qualified by subparagraphs a and b that limit the source of claims covered by the release. Thus, the release language provides that the state releases all claims (as broadly defined in the initial paragraph):

> b. *for future conduct*, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, *including without limitation any future claims for reimbursement for health*

> *care costs* allegedly associated with use of or exposure to Tobacco Products.

(Emphasis added.) The description of the released claims as relating to "future conduct" is also more consistent with a release limited to claims the state could pursue through litigation than one broadly inclusive of legislative action as well.

Further, it is respondents that are released from "liabilities of any nature whatsoever" by the settlement agreement, not respondents' customers and not respondents' products, although that would be the effect of respondents' arguments. As we have noted, it is retail cigarette purchasers who ultimately pay the Health Impact Fee. Respondent manufacturers have no liability or obligation to pay the Health Impact Fee. Respondent distributors remit the Health Impact Fee to the state when they purchase tax stamps, but they are reimbursed for the Health Impact Fee by cigarette retailers who are, in turn, reimbursed by cigarette purchasers. The settlement agreement specifically bars claims of third-party beneficiaries, yet the effect of respondents' arguments is to extend the benefits of the release to retail cigarette purchasers. The bar against third-party beneficiaries is more consistent, in light of Minnesota's cigarette pricing scheme, with the notion that the settlement agreement resolved only claims that could have been brought against these respondents in future litigation than with the notion that the release ensured that the state would not increase cigarette taxes or fees paid by retail cigarette purchasers if the proceeds are to be used to pay for smoking-related health care costs.

Finally, we note that the specific language in the release related to future claims for health care costs, on which respondents rely so heavily, is inconsistent with their own arguments about the scope of the release. Although respondents and the district court both interpret the limitation imposed by the release on future legislative action as restricted to measures specifically directed at recovery of

health care costs, we find no basis for that restriction in the language of the release. Specifically, the language in subparagraph b, expressly referencing claims for future health care costs, contains no such restriction. Instead, what is released are claims for respondents' future conduct based on or related to the use of or exposure to tobacco products, and claims for reimbursement of health care costs are simply *included* among those claims. Therefore, if the language of the release is construed to limit future legislative action, that limitation would not be restricted by the settlement agreement to action directed at recovery of health care costs, but would be virtually without limit. Just as respondents apparently considered it untenable to suggest that the settlement agreement was intended to effect such a broad waiver of legislative authority, we consider it untenable to adopt such a construction.

We conclude that respondents have failed to sustain their burden to show that the release waives the state's sovereign powers in unmistakable terms. We therefore construe the release of claims in the settlement agreement not to preclude legislative enactment of revenue measures directed at recovering future tobacco-related health care costs generally or the Health Impact Fee in particular. The district court erred in granting respondents' motions to enjoin the imposition of the Health Impact Fee on their products, and erred in granting intervenors' motions to enjoin the imposition of the Health Impact Fee on their products.

III.

The district court ruled that imposition of the Health Impact Fee not only violated the settlement agreement, but is also unconstitutional as an impairment of contract in violation of the Contract Clause of the Minnesota Constitution, Minn. Const. art. I, § 11. Because we construe the settlement agreement not to waive the legislature's authority to enact future legislative revenue measures to recover health care costs, the enactment of the Health Impact Fee did not impair

that agreement and therefore did not violate the Contract Clause.

The district court also ruled that enforcement of the Health Impact Fee against only the intervenors' products would violate their constitutional guarantees of equal protection. Based on our ruling, the Health Impact Fee will be enforced as to respondents' products, and there remains no basis for the intervenors' claim of selective enforcement.

Finally, the district court ruled that respondents and intervenors are entitled to refunds or credits to the extent they paid the Health Impact Fee. Because our ruling is that the Health Impact Fee is enforceable as to respondents' and intervenors' products, there is no basis for refunds or credits.

Reversed.

HANSON, J., took no part in the consideration or decision of this case.

SPECIAL CONCURRENCE

PAGE, Justice (concurring specially).

While I concur in the result reached by the court, I write separately to make two points.

First, the state's 1994 litigation against the major tobacco manufacturers was premised on the notion that the tobacco industry – "not the State of Minnesota, or its citizens" – should pay for the health care costs caused by tobacco use. Despite this premise, nothing in the 1998 settlement agreement between the state and respondents required respondents *themselves* to bear the cost of the settlement. Indeed, as we observed in *Council of Independent Tobacco Manufacturers of America v. State*, the manufacturers simply raised their prices to cover the cost of the settlement. ___ N.W.2d ___, 2006 WL 648137 at *2 (Minn. Mar. 16, 2006). As a result, while the state has collected hundreds of millions of dollars in annual payments from tobacco companies thus far under the terms of the 1998 settlement agreement, the

lion's share – perhaps all – of the cost of that settlement has actually been borne by smokers.

It also appears that, despite the premise of the 1994 litigation that tobacco companies should pay for the health effects of their products, none of the proceeds from the tobacco settlement have been used to pay for smoking-related health care costs. *See* Act of May 25, 1999, ch. 243, art. 16, § 3(b), 1999 Minn. Laws 2055, 2243 (specifying that annual tobacco settlement payments go to the state's general fund). Indeed, in 2003, the one-time settlement payments designated in 1999 by the legislature for tobacco use prevention and medical education were transferred to the state's general fund. *See* Act of June 8, 2003, ch. 21, art. 11, § 33, 2003 Minn. Laws 1st Spec. Sess. 2418, 2560, Act of May 25, 1999, ch. 245, art. 11, §§ 1-3, 1999 Minn. Laws 2264, 2672.

Now, with the imposition of the Health Impact Fee and the pass-through of that fee/tax to the consumer, smokers are once again paying for the state's smoking-related health care costs – the same costs one could reasonably have hoped were being paid for by the tobacco companies through the 1998 settlement. On the record before us, it cannot be determined whether the settlement payments, combined with the Health Impact Fee, exceed the state's smoking-related health care costs. But, to the extent that what smokers who are not parties to the settlement agreement pay towards the settlement payments and the Health Impact Fee exceeds those costs, this scheme exacts a direct, although hidden, tax on smokers to fund any manner of nonsmoking-related state expenditures. This hidden tax is neither imposed on nor borne by any other Minnesota taxpayers. Thus, I find this scheme troubling.

Second, while I concur in the result reached by the court, I would reach that result in a different way. I would reach that result in a different way because it is not clear to me that the unmistakability doctrine applies here and because even if it does apply we need not apply it to resolve this case.

I read the settlement agreement and its release of "claims" to unambiguously cover no more than the claims the state brought or could have brought against respondents in the 1994 tobacco litigation or could bring in future litigation. Imposition of the Health Impact Fee does not create such a "claim." Therefore, I would hold that under the unambiguous language of the settlement agreement, imposition of the Health Impact Fee did not violate the settlement agreement.[7]

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[7] In the end, respondents' challenge to the imposition of the Health Impact Fee would seem to be much ado about not very much. While complaining about the Health Impact Fee, respondents acknowledge that the state could impose an excise tax in the exact same amount as the Health Impact Fee and they would have no basis to challenge such a tax. Moreover, when all is said and done, the Health Impact Fee as imposed by the legislature is borne not by respondents but by retail cigarette purchasers.

APPENDIX B -- OPINION OF THE DISTRICT COURT OF MINNESOTA, SECOND JUDICIAL DISTRICT, DATED DECEMBER 20, 2005

District Court of Minnesota, Second Judicial District, Ramsey County.

THE STATE of Minnesota, By Hubert H. Humphrey, III, Its Then Attorney General,

and Blue Cross and Blue Shield of Minnesota, Plaintiffs,

v.

PHILIP MORRIS USA, INC., R.J. Reynolds Tobacco Company, Brown & Williamson

Tobacco Corporation, B.A.T. Industries, P.L.C., British-American Tobacco

Company Limited, Bat (U.K. & Export) Limited, Lorillard Tobacco Company, The

American Tobacco Company, Liggett Group, Inc., The Council for Tobacco

Research-U.S.A., Inc., and The Tobacco Institute, Inc., Defendants,

A.H. HERMEL CANDY & TOBACCO CO.; Henry's Foods, Inc.; Sandstrom's, Inc.;

M.Amundson Cigar & Candy Co., LLP; The Watson Companies, Inc.; Granite City

Jobbing Company, Inc.; Minter Weisman Co.; Segal Wholesale, Inc., Counsel of

Independent Tobacco Manufacturers of America, and Common Wealth Brands, Inc.,

Intervenors.

No. C1-94-8565.

Dec. 20, 2005.

ORDER

FETSCH, J.

The amended Motion of the Defendants' and Defendants' distributors for enforcement of the Settlement Agreement requests that the Court find that the health impact fee (HIF) violates the Settlement Agreement and Stipulation for Entry of Consent Judgment (Settlement Agreement) as to the Defendants and the Defendants' distributors and further requests that the Court declare that the HIF violates the contract clauses of the United States and Minnesota Constitutions.

The intervenors (A.H. Hermel, et al.) move for the same relief. Commonwealth seeks the Court to declare, if it exempts the Defendants from the HIF, the HIF unconstitutional and void.

Counsel for Independent Tobacco Manufacturers of America asks, assuming the named defendants are found not responsible for the HIF, the Court to declare the HIF unconstitutional because it would selectively enforce the HIF against entities similarly situated, constituting a special law because the settling manufacturers and distributors are exempted from the fee and because the distinction between it and the other settling manufacturers and distributors constitutes an arbitrary and capricious classification not relevant to the stated purposes of the HIF, thereby violating the due process provisions of the state and federal constitutions.

Based upon the arguments of counsel and the entire file:

IT IS THEREFORE ORDERED THAT:

1. The oral Order made at the hearing on September 29, 2005 to allow intervention by A.H. Hermel Candy & Tobacco Company, et al., Commonwealth Brands, Inc., and the

Council of Independent Tobacco Manufacturers of America, previously granted, is now CONFIRMED.

2. The Motions of the defendants to find that the Health Impact Fee violates the Settlement Agreement and is unconstitutional are GRANTED.

3. The Motions of the Intervenors to find that the Health Impact Fee cannot be enforced against them because it constitutes a selective enforcement and deprives them of equal protection under the law is GRANTED.

4. The defendants and the intervenors are entitled to credit or refunds, to the extent paid.

5. The attached Memorandum is made a part hereof.

6. Notice to Counsel by mail is sufficient for all purposes.

MEMORANDUM

INTERVENTION

The intervenors have satisfied each prong of Rule 24.01 and 24.02, Minn.R.Civ.P. Intervention is to be granted liberally. *Luthen v. Luthen*, 596 N.W.2d 278 (Minn. Ct. App. 1999). The holding in *Van Meveren v. Van Meveren*, 603 N.W.2d 671 (Minn. Ct. App. 1999) is not apposite to the analysis. *Van Meveren* denied intervention to an adult daughter of the parties in a custody matter involving her minor brothers. That decision must be read in the context of Minnesota statutory and case law. A third person, that is person not one of the parents, may seek custody by a third party custody petition. An adult daughter does not otherwise have a cogniziable interest in the custody dispute over her minor brothers.

The rule is designed to permit intervention as a right if, as a practical matter, the Court's decision in the pending action could impair or impede that party's ability to protect its interest. Here the intervenors have: (1) timely moved to intervene; (2) have an interest relating to the property or

transaction that is the subject of the action, albeit that that interest is contingent and dependent upon how the Court addresses the defendants' motion; (3) have shown that the Court's judgment could impair or impede the parties' ability to protect that contingent interest; and, (4) the intervenors' interests are not adequately represented by the existing parties. *Nash v. Wollan*, 656 N.W.2d 585, 591 (Minn. Ct. App. 2003).

Permissive intervention lies within the District Court's discretion. Here that discretion is exercised in favor of the intervenors who would be unduly delayed or prejudiced by a denial of their participation. *Nash v. Wollan, supra.* The intervenors have shown "a special and concrete stake in the ultimate determination ." *Id*

THE HEALTH IMPACT FEE

Background

The Settlement Agreement mandated that the settling defendants pay to the State of Minnesota funds which approximate two and one quarter (2.25) billion dollars to date. These payments: "are in satisfaction of all of the State of Minnesota's claims for damages incurred by the State . . . including without limitation . . . claims for health care expenditures" A. p. 7., and do "release and forever discharge all Defendants and their . . . distributors . . . from any and all liabilities whatsoever . . . whether legal, equitable or statutory ('Claims') that the State of Minnesota . . . ever had, now has or hereafter can, shall, or may have, as follows:" S.A., III. B. p. 12-13. and also release the defendants

> b. for future conduct, only as to monetary claims directly or indirectly based on, arising out of or in any way related to, In whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care

> costs allegedly associated with use of or exposure to Tobacco Products. S.A., III.B., p. 13

and

> The State of Minnesota hereby covenants and agrees that it shall not hereafter sue or seek to establish civil liability against any person or entity covered by the release provided under Paragraph III.B based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agrees that this covenant and agreement shall be acomplete defense to any such civil action or proceeding. S.A., III., B. p. 13.

HEALTH IMPACT FEE

The Legislature enacted a health impact fee (H.I.F.), the stated purpose of which was "to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths." Laws 2005, First Special Session, Ch. 4, Art. 4, Sec. 2., subd.1.

This legislation seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement.

In addition to the payments required by the agreement, the defendants also agreed to limitations upon their conduct, including not to challenge certain legislation, to produce documents relating to the enactment or repeal or in opposition to state legislation or state executive action, to disclose payments to any state or local official in Minnesota, to discontinue billboards and transit advertisements of tobacco products in this state, not to make any motion picture in the United States which makes reference to or uses as a prop any cigarette, cigarette package, etc., and to cease marketing, licensing, distributing, selling or offering by direct mail.

The limitations were presumably sought by the State to advance the non-smoking cause and thereby lessen the State's health care costs.

The Court rejects the Attorney General's argument that the Settlement Agreement unconstitutionally inhibits the power of the Legislature. The Legislature, while not signatory to, has acquiesced and assented to the settlement by its conduct of actively employing settlement funds to achieve legislative purposes.[1]

The defendants' distributors are parties because the settlement names them as beneficiaries. S.A., III..B., p-12.

The Health Impact Fee, enacted July 14, 2005, became effective August 1, 2005. The purpose of the fee was to reimburse the state for "the cost of smoking attributable expenses incurred by government health care programs [and will be 75 cents per pack]." Office of Governor Tim Pawlenty, *Governor Pawlenty Leads Efforts to Solve Legislative Impasse (May 20, 2005)*, at 1.

The Minnesota Department of Revenue, *Use of Fees versus Taxes* (updated May 18, 2005) characterized a fee as "approximat[ing] the costs incurred by, or imposed upon government. The inclusion of the bill within an "Omnibus Health and Human Services Bill" providing policy and funding, establishing the tobacco health impact fee and appropriating money" clearly indicates that the $.75 per pack was not a tax. Had it been a tax it would have been likely included in the "Omnibus Tax Bill" passed the same day, which bill had provisions relating to the collection of excise and sales taxes on tobacco products. *See* H.F. 138, Art. 6, Section 20. That the state sought reimbursement of tobacco-

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[1] Minn. Stat. § 297F.24 legislatively also acknowledges and acquiesces to the settlement as is more fully discussed below.

related health care costs clearly violates the Settlement Agreement.

The mechanism by which the funds collected by the $.75 H.I.F. also militate against finding that it is a tax, rather than a fee, because the Human Services Commissioner must annually certify to the Finance Commissioner the "tobacco use attributable costs." Upon receipt of that certification, the Finance Commissioner is then mandated to transfer from the H.I.F. fund to the general fund an amount sufficient to offset the certified expenditures. The H.I.F. is imposed upon and collected from the distributors of tobacco products. It is they who are statutorily commanded to pay the H.I.F. and their failure to do so subjects them to license revocation.

A separate lawsuit is not necessary in order to confer jurisdiction upon the district court. That jurisdiction is retained and preserved by the Settlement Agreement, I.A., p. 3.

The Attorney General's reading of the release, which would limit its operating effect only to "judicial claims", ignores definition of claims within the settlement agreement, which is much broader, and includes "liabilities of any nature whatsoever" including those of a "statutory" nature. The H.I.F. is statutory in nature and directly imposes that from which the defendants are protected by the Settlement Agreement.

The Governor's argument that the H.I.F. can be applied to the settling defendants because it was designed "to reduce tobacco use, particularly among youths," is similarly foreclosed by the Settlement Agreement. The Governor's argument that the imposition of the fee H.I.F. on the distributor does not violate the agreement fails to recognize that the distributors are protected in the same manner and to the same extent as are the defendants.

The essential benefits of the settlement agreement to the defendants was that it reduced to liquidated form, those

damages which the state sought to collect by its lawsuit. The state is bound, like any other party is bound, to the contracts to which it freely and knowingly enters, and from which it benefits. For the state now to argue that it is not bound by its contract undermines and potentially eviserates the constitutional provision contained in Article I, Section 11 of the Minnesota Constitution which provides that "No bill of obtainder, ex post facto law, or any law impairing the obligation of contracts shall be passed."

The argument that any interference with the collection of the H.I.F. is an impairment of the legislative power is flawed. The impairment is self-imposed by the Settlement Agreement. While the Legislature is free to raise revenue by means of a tax, and all parties agree that there would be no basis to override such a tax, the purpose of this legislation was to seek governmental reimbursement for the costs associated with tobacco which distinguishes the H.I.F from a tax and makes it a fee.

In the context of the argument of whether or not a municipality's enactment was a revenue-raising device, which would be prohibited, or a fee, the Supreme Court indicated that the key to determining whether or not a particular item is a fee or tax is whether or not it has a direct relationship to the costs which the reimbursement (fee) seeks. *Country Jo, Inc. v. City of Eagan*, 560 N.W.2d 681, 686 (Minn. 1997). The totality of all circumstances, which include the descriptive information released by the Governor's Office and the Department of Revenue, as well as the statutorily expressed purpose, all require the conclusion that the H.I.F. is a fee. The Attorney General makes a number of other arguments in an effort to preserve the H.I.F. The Legislature, however, acknowledges the Settlement Agreement by having passed Minn. Stat. § 297F.24 which contains a "fee in lieu of settlement" imposed upon nonsettling tobacco companies. By this enactment the Legislature approves and endorses the Settlement Agreement, even if its receipt and use of the funds from the agreement were not sufficient to bind it.

The Attorney General argues that the "unmistakability doctrine" is applicable to preserve the H.I.F. He argues that the state cannot waive its soveriegn powers unless it does so in umistakable terms, which, he claims, it has not done. Here the state has consented to a Settlement Agreement which involves neither the eradication or usurpation of its soveriegn power but its assent to a contract, of the nature and type, which the state enters into every day in a variety of situations.

The defendants, in addition to their contractual claim, have proven a "contracts clause" violation which requires them, first, to prove the existence of a contract; second, the impairment of that obligation by state law; and, third, that the impairment is not a reasonable means to a legitimate end protecting the vital interests of the community.

To demonstrate "a significant and legitimate public interest" the "level of impairment increases the level of scrutiny to which the legislation is subjected." *Christenson v. Minneapolis Municipal Employees*, 331 N.W.2d 740, 750-751 (Minn. 1983). Here the state seeks to abrogate that which what it has promised but offers neither to forego future payments or to refund past payments. It is impossible to find that the legislation is a reasonable device which serves the end of protecting the vital interests of the community.

INTERVENORS

By holding that the H.I.F. is not applicable to the distributors of the settling defendants, there is created this dichotomy. The distributors of the nonsettling defendants must collect the $.75 per cigarette package fee, whereas the distributors of the settling defendants do not. The resultant situation creates an anomoly in the marketplace by which the settling defendants' products will have a distinct marketplace advantage in price. The purpose of the legislation was to recover health-related costs and to prevent tobacco use by youths. The youths who smoke will not by this legislation cease smoking. They will cease smoking the more expensive

cigarettes and buy the less expensive cigarettes from the settling defendants' distributors.

Minnesota already imposes a fee on Commonwealth and other non-settling manufacturers to cover the health-related costs of smoking. This is a $.35 per pack fee. Minn. Stat. § 297F.24 (1)(a). The fee is inapplicable to the distributors of the settling defendants and was designed to equalize payments between the settling defendants and other companies that have not settled. The legislative purpose of the H.I.F. was to require all manufacturers to pay. In light of my decision above, the H.I.F., as applied to the distributors of the nonsettling defendants, who comprise approximately ten percent of the market, will be selectively enforced only as to the remaining ten percent. None of the statute's stated statutory goals will be fulfilled. The nonsettling defendants will be singled out and deprived of equal protection under the Uniform Taxation Clause of the Minnesota Constitution. The statute fails because what is left are distinctions which are manifestly arbitrary and fanciful and because it contains a classification not justified by any distinctive means peculiar to this class and contains a legislative purpose which no longer can be achieved. *E.g.*, *Miller Brewing Co. v. State*, 284 N.W.2d 353, 356 (Minn. 1979).

If the resulting classification does not promote the purposes of the statute, it can no longer stand. *Kolton v. County of Anoka*, 645 N.W.2d 403, 411 (Minn. 2002). Requiring the nonsettling distributors to pay the H.I.F. would be the functional equivalent of a special legislation singling out for special privilege the settling defendants and in derogation to the nonsettling defendants under Art. 12, Sec. 1, Minnesota Constitution. *See also Nichols v. Walter*, 33 N.W. 800, 801 (Minn. 1887), standing for the proposition that a law which is general in its passage but special in its application violates the constitution.

There is no manner in which the legislation can be compartmentalized so as to save it in part while declaring it

unconstitutional in part. The law was designed to apply to all cigarette sales and now fails because it is only applicable to ten percent of those sales. *See Minn. Cable Commc'ns Ass'n v. Minn. Cable Commc'ns Bd.*, 288 N.W.2d 721, 723 (Minn. 1980).

APPENDIX C -- JUDGMENT OF THE MINNESOTA SUPREME COURT DATED JUNE 21, 2006

STATE OF MINNESOTA

The State of Minnesota, by Hubert H. Humphrey, III, Its then Attorney General, Appellant, Blue Cross and Blue Shield of Minnesota,

Plaintiff,

vs.

Philip Morris USA, Inc., Respondent, R. J. Reynolds Tobacco Company, et al., Respondents, Brown & Williamson Tobacco Corporation, et al., Defendants, A. H. Hermel Candy & Tobacco Co., et al., intervenors, Respondents, Council of Independent Tobacco Manufacturers of America, intervenor, Respondent, Commonwealth Brands, Inc., intervenor,

Respondent

JUDGMENT

Supreme Court

Appellate Court # A05-2540

Trial Court # C1-94-8565

Pursuant to a decision of Supreme Court duly made and entered, it is determined and adjudged that the decision of the Ramsey County District Court, Civil Division herein appealed from be and the same hereby is reversed and judgment is entered accordingly. A certified copy of the entry of judgment and the court's decision is herewith transmitted and made part of the remittitur.

Dated and signed: June 21, 2006

FOR THE COURT

Attest: Frederick K. Grittner

Clerk of the Appellate Courts

By: /s

Assistant Clerk

STATE OF MINNESOTA SUPREME COURT

TRANSCRIPT OF JUDGMENT

I, Frederick K. Grittner, Clerk of the Appellate Courts, do hereby certify that the foregoing is a full and true copy of the Entry of Judgment in the cause therein entitled, as appears from the original record in my office that I have carefully compared the within copy with said original and that the same is a correct transcript therefrom.

Witness my signature at the Minnesota Judicial Center,

In the City of St. Paul June 21, 2006

Dated

Frederick K. Grittner

Clerk of the Appellate Courts

By: /s/

Assistant Clerk

APPENDIX D -- CONTRACTS CLAUSE OF THE UNITED STATES CONSTITUTION

> No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.

U.S. Const. art. I, § 10, cl. 1.

APPENDIX E – MINNESOTA STATUTES § 16A.725

16A.725. Health impact fund and fund reimbursements

Subdivision 1. Health impact fund. There is created in the state treasury a health impact fund to which must be credited all revenue from the health impact fee under section 256.9658 and any floor stocks fee enacted into law.

Subd. 2. Certified tobacco expenditures. By April 30 of each year, the commissioner of human services shall certify to the commissioner of finance the state share, by fund, of tobacco use attributable costs for the previous fiscal year in Minnesota health care programs, including medical assistance, general assistance medical care, and MinnesotaCare, or other applicable expenditures.

Subd. 3. Fund reimbursements.

(a) Each fiscal year, the commissioner of finance shall first transfer from the health impact fund to the general fund an amount sufficient to offset the general fund cost of the certified expenditures under subdivision 2 or the balance of the fund, whichever is less.

(b) If any balance remains in the health impact fund after the transfer in paragraph (a), the commissioner of finance shall transfer to the health care access fund the amount sufficient to offset the health care access fund cost of the certified expenditures in subdivision 2, or the balance of the fund, whichever is less.

Minn. Stat. § 16A.725.

APPENDIX F -- MINNESOTA STATUTES § 256.9658

256.9658. Tobacco health impact fee

Subdivision 1. Purpose. A tobacco use health impact fee is imposed on and collected from cigarette distributors and tobacco products distributors to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths.

Subd. 2. Definitions. The definitions under section 297F.01 apply to this section.

Subd. 3. Fee imposed. (a) A fee is imposed upon the sale of cigarettes in this state, upon having cigarettes in possession in this state with intent to sell, upon any person engaged in business as a distributor, and upon the use or storage by consumers of cigarettes. The fee is imposed at the following rates:

(1) on cigarettes weighing not more than three pounds per thousand, 37.5 mills on each cigarette; and

(2) on cigarettes weighing more than three pounds per thousand, 75 mills on each cigarette.

(b) A fee is imposed upon all tobacco products in this state and upon any person engaged in business as a distributor in an amount equal to the liability for tax under section 297F.05, subdivision 3, or on a consumer of tobacco products equal to the tax under section 297F.05, subdivision 4. Liability for the fee is in addition to the tax under section 297F.05, subdivision 3 or 4.

Subd. 4. Payment. A distributor must pay the fee at the same time and in the same manner as provided for payment of tax under chapter 297F.

Subd. 5. Fee on use of unstamped cigarettes. Any person, other than a distributor, that purchases or possesses cigarettes that have not been stamped and on which the fee imposed under this section has not been paid is liable for the fee under

this section on the possession or use of those cigarettes.

Subd. 6. Administration. The audit, assessment, interest, appeal, refund, penalty, enforcement, administrative, and collection provisions of chapters 270C and 297F apply to the fee imposed under this section.

Subd. 7. Cigarette stamp. (a) The stamp in section 297F.08 must be affixed to each package and is prima facie evidence that the fee imposed by this section has been paid.

(b) Notwithstanding any other provisions of this section, the fee due on the return is based upon actual stamps purchased during the reporting period.

Subd. 8. License revocation. The commissioner of revenue may revoke or suspend the license of a distributor for failure to pay the fee or otherwise comply with the requirements under this section. The provisions and procedures under section 297F.04 apply to a suspension or revocation under this subdivision.

Subd. 9. Deposit of revenues. The commissioner of revenue shall deposit the revenues from the fee under this section in the state treasury and credit them to the health impact fund.

APPENDIX G – BRIEF OF RESPONDENTS BEFORE THE MINNESOTA SUPREME COURT

Supreme Court of Minnesota.

The State of MINNESOTA, by Hubert H. Humphrey III its then Attorney General, et al., Petitioner,

v.

PHILIP MORRIS USA, INC., et al., Respondents.

No. A05-2540.

March 2, 2006.

Brief for Respondents Settling Defendants and Defendants' Distributors

LEGAL ISSUES

I. Are the Settling Defendants and their distributors released from liability under the Health Impact Fee, which attempts "to recover for the state health costs related to or caused by tobacco use," by the 1998 Settlement Agreement and Release, which releases the Settling Defendants and their distributors from "liabilities of any nature whatsoever," including "statutory" liability, "for reimbursement for [state] health care costs allegedly associated with use of or exposure to Tobacco Products?"

The district court held that the Health Impact Fee "seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement," and that the "state sought reimbursement of tobacco-related health care costs [through the Health Impact Fee] clearly violates the Settlement Agreement." (State's Appendix ("App.") 12-13.)

Sorenson v. Coast-to-Coast Stores, Inc., 353 N.W.2d 666 (Minn. Ct. App. 1984);

Chun King Sales, Inc. v. County of St. Louis, 98 N.W.2d 194 (Minn. 1959);

Downing v. Independent School District No. 9, 291 N.W. 613 (Minn. 1940);

United States Trust Co. of New York v. New Jersey, 431 U.S. 1 (1977).

II. Does the State's enforcement of the Health Impact Fee as to Settling Defendants' products violate the Contracts Clauses of the Minnesota and United States Constitutions by impairing the State's contractual obligation under the Settlement Agreement to release the Settling Defendants and their distributors from any further "liabilities of any nature whatsoever," including "statutory" liability, for the State's health care costs?

The district court held that the Health Impact Fee "undermines and potentially eviscerates the constitutional provision contained in Article I, Section 11 of the Minnesota Constitution which provides that 'No . . . law impairing the obligation of contracts shall be passed,' " and likewise violates the Contracts Clause of the United States Constitution. (App. 14-15.)

United States Constitution article I, section 10, clause 1;

Minnesota Constitution article I, section 11;

Murray v. City of Charleston, 96 U.S. 432 (1877);

Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978).

III. Do the defenses invoked by the State to avoid enforcement of the Settlement Agreement - the unmistakability doctrine, separation of powers, and Article X, Section 1 of the Minnesota Constitution - apply where, as here, the Settlement Agreement does not purport to surrender any of the State's powers, but simply releases any future liability for reimbursement of State health care costs attributable to smoking?

The district court held that the unmistakability doctrine, separation of powers, and Article X, Section 1 do

not apply here because, among other reasons, the Settlement Agreement "involves neither the eradication or usurpation of its sovereign power." (App. 16.)

United States v. Winstar Corp., 518 U.S. 839 (1996);

Kimberly Assocs. v. United States, 261 F.3d 864 (9th Cir. 2001);

Butler v. Hatfield, 152 N.W.2d 484 (Minn. 1967);

Country Joe, Inc. v. City of Eagan, 560 N.W.2d 681 (Minn. 1997).

STATEMENT OF THE CASE

On May 8, 1998, Respondents Philip Morris USA Inc., R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company ("Settling Defendants") entered into a Settlement Agreement and Stipulation for Entry of Consent Judgment with the State of Minnesota ("Settlement Agreement"), ending litigation initiated by the State in 1994. (App. 37-82.[1] The Settlement Agreement requires the Settling Defendants to make annual payments of hundreds of millions of dollars and to abide by a series of advertising, marketing, and other restrictions on future conduct. (App. 43-50, 54-59.) These monetary and other obligations continue in perpetuity. (*Id.*) In exchange, the *only* tangible benefit provided to the Settling Defendants under the Settlement Agreement was a broad, comprehensive "Release and Discharge" of Settling Defendants and their distributors from all liabilities - past, present, and future - for reimbursement of State health care costs attributable to tobacco use (the "Release" or "Release Provision"). (App. 50-52.) The Release provides in relevant part:

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[1] A fourth tobacco manufacturer signatory to the Settlement Agreement, Brown & Williamson Tobacco Corporation, combined its United States operations with R.J. Reynolds Tobacco Company in 2004.

> [T]he State of Minnesota shall release and forever discharge all [Settling] Defendants and their . . . distributors . . . from . . . liabilities of any nature whatsoever . . . whether legal, equitable or statutory ("Claims") that the State of Minnesota . . . ever had, now has or hereafter can, shall or may have . . . for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

(App. 50-52.)

On July 14, 2005, Governor Pawlenty signed into law a statute imposing a 75-cent per pack "Health Impact Fee" on all cigarettes sold in the State. (App. 33-36.) The express purpose of the Health Impact Fee is "to recover for the state health costs related to or caused by tobacco use." (App. 33.)

On August 26, 2005, the Settling Defendants and several of their distributors brought a "Motion for Enforcement of Settlement Agreement" in the District Court for Ramsey County, contending that the State's enforcement of the Health Impact Fee as to the Settling Defendants' products constituted an attempt to recover the same costs that the State had already released and was contractually barred from recovering under the Settlement Agreement - health care costs attributable to tobacco use. (App. 1-5.)[2] Settling Defendants and their distributors asked the district court to issue an order enforcing the Settlement Agreement and finding that it is a complete

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[2] The following ten distributors of Settling Defendants' products are Respondents to this appeal: A.H. Hermel Candy & Tobacco Co.; Henry's Foods, Inc.; Sandstrom's, Inc.; Johnson Candy and Tobacco Co. of Brainerd, Inc.; M. Amundson Cigar & Candy Company LLP; The Watson Companies, Inc.; Granite City Jobbing Company, Inc.; Minter-Weisman Co.; Segal Wholesale, Inc.; and Tyler Wholesale, Inc.

defense and bar to any attempt by the State to collect the Health Impact Fee with respect to Settling Defendants' products. (*Id.*)

The district court, Honorable Michael F. Fetsch presiding, heard oral argument on the Settling Defendants' motion on September 29, 2005. (Supplemental Appendix ("Supp. App.") 1.) At that time, the court granted the motion to intervene of non-settling cigarette manufacturer Commonwealth Brands, Inc. and the Council of Independent Tobacco Manufacturers of America, as well as Governor Tim Pawlenty's motion to appear as *amicus curiae.* (Supp. App. 35; App. 9.)

On December 20, 2005, the district court granted the Settling Defendants' motion and issued an Order and Memorandum declaring that enforcement of the Health Impact Fee with respect to the Settling Defendants' products violates both the Settlement Agreement and the Contracts Clauses of the Minnesota and United States Constitutions. (App. 6-18.) The district court found that the Health Impact Fee "seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement" (App. 12), and that the "state sought reimbursement of tobacco-related health care costs [through the Health Impact Fee] clearly violates the Settlement Agreement." (App. 13.) The district court further held that the Health Impact Fee "undermines and potentially eviscerates the constitutional provision contained in Article I, Section 11 of the Minnesota Constitution which provides that 'No . . . law impairing the obligation of contracts shall be passed,' "and likewise violates the Contracts Clause of the United States Constitution. (App. 14-15.) Finally, the district court also held that the Health Impact Fee also could not be enforced on the products of non-settling tobacco companies. (App. 16-18.)

On December 28, 2005, the State noticed this appeal. (App. 28-30.) On January 18, 2006, by agreement of the parties, the district court stayed its judgment pending appeal

and required that the State maintain funds collected during appeal in a separate fund. (App. 19-27.)

STATEMENT OF FACTS

A. The State's 1994 Suit for Reimbursement of Tobacco-Related Health Care Expenditures

In 1994, the State filed a lawsuit against numerous tobacco manufacturers, including the Settling Defendants. (Supp. App. 107.) The Attorney General brought suit "on behalf of the State of Minnesota pursuant to his authority under common law, as well as Minn. Stat. §§ 8.01, 8.31, 325D.09-15, 325D.43-45, 325D.49-66, and 325F.67-70," to recover the State's alleged tobacco-related health care expenditures. (Supp. App. 110.)

The suit's purpose was "to vindicate the State's proprietary interest in enforcing the State's right to damages for economic injuries to the State which were caused by the unlawful actions of the cigarette industry." (*Id.*) These economic injuries included "increased expenditures" by State health care programs, such as "Minnesota's Medicaid Plan, Medical Assistance," "General Assistance Medical Care," "Minnesota Care," and "[t]he State Employee Group Insurance Program," due to tobacco-related illnesses. (Supp. App. 110-13.) In the State's words, the "premise" of its suit was that "the [tobacco] industry - and not the State of Minnesota, or its citizens ··· - should pay for the staggering health costs" attributable to tobacco use. (Supp. App. 110.)

B. The State's 1998 Settlement and Release of All Future Claims for Health Care Costs Attributable to Tobacco Use

On May 8, 1998, the State and Settling Defendants signed a Settlement Agreement that settled and released the State's suit and past claims as well as "any future claims for reimbursement for health costs allegedly associated with use of or exposure to Tobacco Products." (App. 51.) The Attorney General signed the Settlement Agreement on behalf of the "State of Minnesota" as the State's "duly elected and

authorized Attorney General" (App. 66), and the parties agreed that the Settlement Agreement would "be final and binding upon all Parties" upon approval by the district court. (App. 60.) The district court approved the Settlement Agreement on May 8, 1998. (App. 82.)

The Settlement Agreement obligates the Settling Defendants to pay hundreds of millions of dollars in "annual payments" into "an account designated in writing by the State" to reimburse the State for health care costs attributable to tobacco. (App. 44.) In particular, the Settling Defendants agreed to make six payments totaling approximately $1.31 billion (subject to annual adjustments for changes in industry-wide volume and inflation) from September 5, 1998 through January 2, 2003. (App. 44-45.) In addition, starting on December 31, 1998, and continuing "annually thereafter on December 31st of each year after 1998" in perpetuity, the Settling Defendants were required to pay 2.55% of the following amounts (again, subject to annual adjustments for changes in industrywide volume and inflation):

1998	$4 Billion
1999	$4.5 Billion
2000	$5 Billion
2001	$6.5 Billion
2002	$6.5 Billion
2003	$8 Billion
Thereafter	$8 Billion.

(App. 47.) Each annual payment is "in satisfaction of all of the State of Minnesota's claims for damages incurred by the State in the year of such payment or earlier years ··· including, without limitation··· claims for [tobacco-related] health care expenditures." (App. 43.)

Pursuant to the Settlement Agreement, the Settling Defendants have paid the State a total of approximately $2.25 billion to date. (App. 44-47.) The State has been "actively employing settlement funds to achieve legislative purposes" for nearly eight years. (App. 12.) In addition to the foregoing monetary payments, the Settling Defendants agreed to significant restrictions on their future conduct. This included agreements, among other things, (1) not to oppose passage of six specified categories of "future Minnesota legislative proposals or administrative rules" (App. 54, 69), (2) not to "[f]acially challenge the enforceability or constitutionality of existing Minnesota laws or rules relating to tobacco control" (App. 54); and (3) to accept prohibitions on certain marketing, advertising, and promotional activities. (App. 57-58.)

In return for these monetary and other present and future contractual obligations, the *only* tangible benefit provided to the Settling Defendants under the Settlement Agreement was a broad, comprehensive "Release and Discharge" of all claims by the State - past, present, and future - for reimbursement of health care costs attributable to tobacco. (App. 50-52.) The Release provides:

> [T]he State of Minnesota shall release and forever discharge all [Settling] Defendants and their··· distributors ··· from any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as ***9** costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official

> capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly, representatively, derivative or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:
>
> ....
>
> b. for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

(App. 50-51.) The State further "covenant[ed] and agree[d] that it shall not hereafter sue or seek to establish civil liability against any person or entity covered by [the Release] based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agrees that this covenant and agreement shall be a complete defense to any such civil action or proceeding." (App. 52.) The Release specifically names the Settling Defendants' distributors as released parties. (App. 50.)

The Attorney General signed the Settlement Agreement on behalf of "the State of Minnesota." (App. 66.) The State of Minnesota is defined broadly to include, among others, "any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement." (App. 51.)

C. The Legislature's Ratification of the Settlement Agreement

The State Legislature has accepted every payment made by the Settling Defendants under the Settlement Agreement. (App. 12.) For nearly eight years, the State has used this revenue to fund various programs and expenditures.[3]

In addition, in 2003, the Legislature enacted Minn. Stat. § 297F.24, entitled "Fee in Lieu of Settlement." Section 297F.24 imposes a 35-cent per pack fee on "nonsettlement cigarettes." Minn. Stat. § 297F.24(a).[4] Section 297F.24 provides that cigarette manufacturers who were not parties to the Settlement Agreement may enter an agreement with the State that mirrors the terms of the Settlement Agreement, and thereby avoid payment of the 35-cent per pack fee.

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[3] *See, e.g.*, House Fiscal Analysis Dep't, *Summary of Fiscal Actions of the 2005 Legislature* (Oct. 2005) at 2-3 (excerpted at Gov. App. 1). (Supp. App. 164-65.)

[4] Section 297F.24 defines "nonsettlement cigarettes" as follows:

> [C]igarette[s] manufactured by a person other than a manufacturer that:
>
> (1) is making annual payments to the state of Minnesota under a settlement of the lawsuit styled as State v. Philip Morris Inc., No. C 1-94-8565 (Minnesota District Court, Second Judicial District)···
>
> (2) has voluntarily entered into an agreement with the state of Minnesota, approved by the attorney general, agreeing to terms similar to those contained in the settlement agreement, identified in clause (1) including making annual payments to the state, with respect to its national sales of the style of cigarettes, equal to at least 75 percent of the payments that would apply if the manufacturer was one of the four original parties to the settlement agreement required to make annual payments to the state.

Minn. Stat. § 297F.24(2).

D. The State's Creation of a Health Impact Fee To Recover State Health Care Costs Attributable to Tobacco

On July 14, 2005, Governor Pawlenty signed into law a statute creating a 75-cent per pack "Health Impact Fee" on all tobacco products, including Settling Defendants' products, "to recover for the state health costs related to or caused by tobacco use." (App. 33.) The Health Impact Fee became effective on August 1, 2005. (App. 33.)

When Governor Pawlenty first proposed the Health Impact Fee on May 20, 2005, he explained that it "will be related to the cost of smoking attributable expenses incurred by government health care programs." (Supp. App. 166.) He further explained that the 75-cent amount of the fee "was arrived at based on the impact of tobacco use o[n] the state's public funded health programs, such as Medical Assistance, GAMC and Minnesota Care." (Supp. App. 166-67.)

The Health Impact Fee legislation mandates that revenues collected under the Health Impact Fee be credited to a "Health Impact Fund" to be used to pay health care costs that the State attributes to smoking. (App. 33.) Each year, the Commissioner of Human Services must "certify to the commissioner of finance the state share, by fund, of tobacco use attributable costs for the previous fiscal year in Minnesota health care programs, including medical assistance, general assistance medical care, and MinnesotaCare, or other applicable expenditures." (App. 33.) The Commissioner of Finance must then "transfer from the health impact fund to the general fund an amount sufficient to offset the general fund cost of the certified expenditures" for health care costs attributable to tobacco use. (*Id.*)

To demonstrate that the proposed Health Impact Fee was legally a "fee" and not a "tax," the Governor released a publication of the Minnesota Department of Revenue entitled "Use of Fees vs. Taxes." (Supp. App. 171.) In this publication, the Department of Revenue distinguished the features of fees from those of taxes, specifically noting that a

fee "approximate[s] the costs incurred by, or imposed on, government" by an industry. (*Id.*)

The Health Impact Fee was also included within the "Omnibus Health and Human Services Bill" (App. 13), and dedicated to the payment of the annual health care costs incurred by the State attributable to tobacco use. (App. 33-34.) The entire bill related solely to health and human services. (App. 13.) The same day as that bill was signed into law, an "Omnibus Tax Bill" was enacted, which includes provisions relating to the collection of excise and sales taxes on tobacco products, but does not mention the Health Impact Fee. (App. 13.)

E. The Settling Defendants and Defendants' Distributors' Motion for Enforcement of the Settlement Agreement

On August 26, 2005, the Settling Defendants and several of their distributors filed a "Motion for Enforcement of Settlement Agreement" in the Ramsey County District Court.[5] The Settling Defendants asked the district court to find that the Settlement Agreement acts as a complete defense and bar to any attempt by the State to collect the Health Impact Fee with respect to Settling Defendants' products.

On December 20, 2005, after extensive briefing and argument, the district court granted the Settling Defendants' and Defendants' Distributors' motion. The district court found that the Health Impact Fee violated the plain language of the Settlement Agreement: "[The Health Impact Fee]

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[5] The Settlement Agreement provides that the District Court of Ramsey County (Second Judicial District) "shall retain jurisdiction for the purpose of implementing and enforcing this Settlement Agreement. " (App. 39.) The parties also "agree[d] to present any disputes under th[e] Settlement Agreement, including without limitation any claims for breach or enforcement of this Settlement Agreement, exclusively to this Court." (*Id.*)

seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement," namely "reimbursement of tobacco-related health care costs." (App. 12.) The district court rejected the State's argument that the Release applied only to "judicial" or "adjudicatory" claims:

> The Attorney General's reading of the release, which would limit its operating effect to "judicial claims," ignores [the] definition of claims within the settlement agreement, which is much broader, and includes "··· liabilities of any nature whatsoever" including those of a "statutory" nature. The [Health Impact Fee] is statutory in nature and directly imposes that from which the defendants are protected by the Settlement Agreement.

(App. 14.)

The district court further held that the Health Impact Fee impaired the Settlement Agreement in violation of the Contracts Clauses of the Minnesota and United States Constitutions:

> The state is bound, like any other party is bound, to the contracts to which it freely and knowingly enters, and from which it benefits. For the state now to argue that it is not bound by its contract undermines and potentially eviscerates the constitutional provision contained in Article I, Section 11 of the Minnesota Constitution which provides that "No ··· law impairing the obligation of contracts shall be passed."

(App. 14-15.)

The district court rejected the State's reliance on the "unmistakability" doctrine, finding that the doctrine did not apply and could not excuse the State's abrogation of its own contractual obligations. (App. 16.) The court likewise

rejected the State's separation of powers argument, noting that any doubt on that issue was eliminated by the fact that the Legislature "has acquiesced and assented to the settlement by its conduct of actively employing settlement funds" and in passing a "Fee in Lieu of Settlement," Minn. Stat. § 297F.24. (App. 12, 15.) Finally, applying this Court's well-settled criteria for determining whether a governmental imposition is a tax or a fee, the district court concluded that the Health Impact Fee was a fee and therefore the Minnesota Constitution's ban on the "surrender" of the Legislature's power to tax (Article X, Section 1) did not apply. (App. 15.) Finally, the Court granted the intervenors' motion to prevent the Health Impact Fee from being enforced also against them.

The State now appeals the district court's Order, raising essentially the same grounds that the district court rejected.

STANDARD OF REVIEW

A district court's application of the law and interpretation of contracts are subject to *de novo* review by this Court. *Employers Mut. Cas. Co. v. A.C.C.T., Inc.*, 580 N.W.2d 490, 493 (Minn. 1998).

SUMMARY OF THE ARGUMENT

As the district court held, under the clear and unambiguous terms of the Settlement Agreement, enforcement of the Health Impact Fee with respect to the Settling Defendants' products is an attempt to recover liabilities that the State has already released and for which the Settling Defendants are already paying hundreds of millions of dollars in annual payments in perpetuity. The Health Impact Fee is covered by the plain terms of the Release and cannot be enforced with respect to the Setting Defendants' products without violating the Settlement Agreement and impairing that contract in violation of the Contracts Clauses of the Minnesota and United States Constitutions.

The release at issue here is not a limited one, but a broad release of all past, present, and future "liabilities of any nature whatsoever," including "statutory" liability, "for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products." The statute at issue here is not a hypothetical excise tax, but a "Health Impact Fee" that is expressly designed "to recover for the state health care costs related to or caused by tobacco use." The two could not be more in conflict.

If the State can enforce the Health Impact Fee with respect to the Settling Defendants' products, then the State's promises and releases in the Settlement Agreement would not be worth the paper on which they are written. The State would have successfully nullified the only tangible benefit provided to the Settling Defendants under the agreement -- a release from additional liability for the State's health care costs. Neither state law nor the state and federal Contracts Clauses allows such a result. The consequences of such a ruling for future potential settlements and contracts that the State seeks to enter would be dramatic.

The State makes a series of arguments in an attempt to avoid the Release. None withstands scrutiny. First, the State asserts that, despite its clear language to the contrary, the Settlement Agreement does not bar the imposition of the *statutory* liability imposed by the Health Impact Fee, but only "adjudicatory" liability. The State's argument ignores the plain language of the Settlement Agreement, which expressly releases "liabilities of any nature whatsoever," including "statutory" liability. The limiting word "adjudicatory" appears only in the State's briefs and nowhere in the Settlement Agreement. As a matter of ordinary contract law, the Settlement Agreement releases Settling Defendants from the statutory liability of the Health Impact Fee.

Second, the State asserts that, even if the Release applies, it must be disregarded because of the "unmistakability doctrine," separation of powers, and Article

X, Section 1 of the Minnesota Constitution. Each of these arguments is premised on the same fundamental mischaracterization of the Settlement Agreement and Settling Defendants' contentions. Settling Defendants do *not* contend that the Settlement Agreement "surrendered" any legislative powers, nor is that what the Settlement Agreement provides. Rather, the State agreed to release Settling Defendants from future "liabilities of any nature whatsoever," including "statutory" liability, for the recovery of health care costs attributed to their products. The State was fully within its power to provide such a release, and none of the doctrines that the State invokes bars enforcement of the Release or gives the State the prerogative to nullify its agreements. If the State were correct, a contract would never be binding on and enforceable against the State, as it could always be unilaterally revoked by a subsequent act of the Legislature. As explained below, that is *not* the law.

The district court correctly held that the State is bound by the terms of its Release and must fully perform its obligations under the Settlement Agreement.

ARGUMENT

I. The District Court Correctly Ruled That the Settlement Agreement Released the Settling Defendants and Their Distributors from the Liability Imposed by the Health Impact Fee.

The law treats the State in the same way it treats any other party that enters into a contract. As this Court held in *Chun King Sales, Inc. v. County of St. Louis*, 98 N.W.2d 194 (Minn. 1959), "when the state enters into a contract . . . its rights and liabilities are the same as a private person." *Id.* at 200; *see United States v. Winstar Corp.*, 518 U.S. 839, 887 n.32 (1996) ("[T]he government is ordinarily treated just like

a private party in its contractual dealings.").[6] The Settlement Agreement must therefore be interpreted according to "[t]he cardinal rule in the interpretation of contracts," which is "to ascertain the intention of the parties and to give effect to that intention if it can be done consistently with legal principles." *Downing v. Indep. Sch. Dist. No.* 9, 291 N.W. 613, 616 (Minn. 1940) (quotations and citations omitted).

"[T]he law presumes that parties to a release agreement intend what is expressed in a signed writing." *Sorenson v. Coast-to-Coast Stores, Inc.*, 353 N.W.2d 666, 670 (Minn. Ct. App. 1984). Accordingly, this Court must look to the language of the Settlement Agreement to determine whether enforcement of the Health Impact Fee as to Settling Defendants' products violates that contract.

The Settlement Agreement expressly releases the precise liability that the Health Impact Fee seeks to impose. The Settlement Agreement "release[s] and forever discharge[s]" Settling Defendants from:

> [A]ny and all . . . liabilities of any nature whatsoever··· whether legal, equitable or statutory ("Claims") that the State of Minnesota . . . ever had, now has or hereafter can, shall, or may have, as follows:
>
> . . .
>
> b. for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in

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[6] *See also* 72 Am. Jur. 2d *States, Territories, and Dependencies* § 70 ("A state may lay aside its sovereignty and, like a private individual or corporation, contract either with other public bodies or with private persons, and be bound as a private person would be bound under a similar contract.").

> part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

(App. 50-51.) (emphasis added) Yet, the Health Impact Fee seeks "to recover for the state health costs related to or caused by tobacco use." (App. 33.) As the district court held, the Health Impact Fee thus "seeks to recover those costs from the settling defendants which are prohibited by the settlement agreement" (App. 12), and "directly imposes that from which the defendants are protected by the Settlement Agreement." (App. 14, 33.)

The State seeks to escape this conclusion by rewriting the contract. On fourteen occasions in its brief, the State describes the Release as limited to "adjudicatory claims." *See, e.g.*, State's Br. at 1, 11, 13, 14, 15-17. Yet, the term "adjudicatory" is a limiting term of the State's own creation that appears nowhere in the parties' contract. The Settlement Agreement in fact says precisely the opposite, defining "claims" in the broadest possible terms to include not just judicial liability, but "liabilities of any nature whatsoever" including "statutory" liability. (App. 50-51.)

This textual expression of the broad purpose of the Release makes perfect sense given the parties' obvious intent in entering a settlement agreement that requires defendants to pay hundreds of millions of dollars per year in perpetuity. *See, e.g., Kane v. Oak Grove Co.*, 22 N.W.2d 588, 590 (Minn. 1946) ("Words employed [in a contract] . . . are to be interpreted so as to subserve, and not subvert, the general intention of the parties."). The Settlement Agreement was clearly not a simple resolution of an individual lawsuit. If so, it would have been conditioned on a single payment. On the contrary, the Settlement Agreement was a far-reaching and forward-looking resolution of past, present *and future*

liabilities. The parties agreed that, in exchange for the Settling Defendants' agreement to make hundreds of millions of dollars in payments annually in perpetuity, the State would release and discharge "liabilities of any nature whatsoever" -- including future "statutory" liability -- with respect to health care costs attributable to smoking. As the district court explained, "[t]he essential benefits of the settlement agreement to the defendants was that it reduced to liquidated form, those damages which the state sought to collect by its lawsuit." (App. 14.) In other words, each year's payments resolve any potential liabilities for that year's (and all prior years') tobacco-related health care costs. (App. 43-44.)

To adopt a contrary interpretation is to assume that the parties intended to give the State the unilateral and unlimited right to renege on its bargain as long as the State does so through legislation. The Settling Defendants would continue to be bound by the Agreement, would continue to pay hundreds of millions of dollars each year, and the State would continue to accept those monies, but the State could impose additional liabilities as long as it acts through the Legislature. Such a result is contrary to the clear intention of the parties as expressed in the broad release language and would render the Settling Defendants' "essential benefits" under the Settlement Agreement wholly illusory. This Court must avoid such a result. In the words of the United States Supreme Court, a contract that gives one party the power "to deny or change the effect of the promise, is an absurdity." *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 25 n.23 (1977); *see also Cont'l Ill. Nat'l Bank & Trust Co. v. Washington*, 696 F.2d 692, 698 (9th Cir. 1983).

This Court should likewise reject the State's argument that the phrase "liabilities of any nature whatsoever" cannot apply to the Health Impact Fee because the same language appears in the release that the Settling Defendants provided to the State. *See* State's Br. at 20. Both Releases were written in the broadest possible terms. The purpose of the mutual releases was to bind the parties to the full extent of their

respective powers. The State has the power to impose liability through legislation; the Settling Defendants do not. The fact that the State possesses greater powers to impose liabilities does not mean that the phrase should be restricted to release only some of the liabilities that the State has the power to impose. Rather, the phrase must be read in accordance with its express, unambiguous meaning and applied to each party in accordance with that party's power to seek liability.

Equally misguided is the State's attempt to limit the scope of the Release to "statutory claims" such as those for "consumer fraud, false advertising, and antitrust." State's Br. at 20. "Statutory claims" is yet another phrase that appears nowhere in the text of the Settlement Agreement. As the Release is written, the term "statutory" modifies *all* of the preceding terms within the definition of "claims," including "civil claims," "demands," "actions," "suits and causes of action," as well as "liabilities of any nature whatsoever." (App. 50-51.) As the district court recognized, although "statutory civil claims" certainly are covered, the Release is not limited to such claims. It expressly covers " ' . . . liabilities of any nature whatsoever' including those of a 'statutory' nature. The [Health Impact Fee] is statutory in nature" and therefore falls within the Release. (App. 14.)[7]

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[7] Equally baseless is the State's attempt to limit the scope of the Release by arbitrarily carving it up into three supposed "categories" of litigation-related expenses. *See* State's Br. at 16. There is no indication of such a tripartite structure in the text of the Release: the State's three purported "categories" are not numbered, and there is nothing in the punctuation of the provision, such as semicolons, to suggest the grouping the State asserts. Moreover, the language of the Release is not consistent with the categories the State creates. As just one example, "liabilities of any nature whatsoever" by its very terms is much broader than simply "expenses that can result from the adjudication of claims." *See, e.g.*, *Black's Law Dictionary* 914 (6th ed. 1991) (defining "liability" to include "every kind

(Continued...)

Finally, this Court should reject the State's argument that the Release should somehow be limited because the parties used the term "legislation" elsewhere in the Settlement Agreement, but not in the Release. *See* State's Br. at 17-18. The plain and ordinary meaning of the term the parties did use in the release -- "statutory" -- includes legislation. *See, e.g.*, Black's Law Dictionary (6th ed. 1991) (defining "statutory" as "relating to a statute" and defining "statute" as "[a] formal written enactment of a legislative body"). Under well-settled Minnesota law, that plain and ordinary meaning governs here. *See, e.g., Turner v. Alpha Phi Sorority House*, 276 N.W.2d 63, 67 (Minn. 1979) ("[T]he language found in a contract is to be given its plain and ordinary meaning."). As the district court found, the Health Impact Fee "is statutory in nature" and thus falls within the terms of the Release. (App. 14.)

The district court properly interpreted the Release in accordance with its plain language and correctly held that it releases the Settling Defendants and their distributors from the liability that the State now seeks to impose through the Health Impact Fee.

II. The District Court Correctly Held That the Health Impact Fee, if Applied to the Settling Defendants' Products, Would Violate the Contracts Clauses of the Minnesota and United States Constitutions.

Whether enacted pursuant to the taxing power, police power, or any other legislative power, the Health Impact Fee is subject to the Contracts Clauses of the Minnesota and United States Constitutions. *See* U.S. Const. art. I, section 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligations of Contracts."); Minn. Const. art. I, section 11

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of legal obligation, responsibility, or duty" and "all characters of debts and obligations," including "taxes").

("No . . . law impairing the obligation of contracts shall be passed.").[8] As the New Hampshire Supreme Court has explained: "the State cannot resort to contract violations to solve its financial problems ···· '[T]he most basic purposes of the [contracts] clause, as well as the notions of fairness that transcend the clause itself, point to a simple constitutional principle: *government must keep its word.*'" *Opinion of the Justices,* 609 A.2d 1204, 1211 (N.H. 1992) (quoting L. Tribe, *American Constitutional Law* 470 (1978) (emphasis in original)). The district court correctly ruled the State may not, under the Contracts Clause, enforce legislation that has the effect of undermining or avoiding its own contractual obligations:

> The state is bound, like any other party is bound, to the contracts to which it freely and knowing enters, and from which it benefits. For the state now to argue that it is not bound by its contract undermines and potentially eviscerates the constitutional provision contained in Article I, Section 11 of the Minnesota Constitution which provides that "No .... law impairing the obligation of contracts shall be passed."

(App. 14-15.)

The State does not dispute that, if this Court affirms the district court's ruling that the Release applies here, this Court should necessarily affirm the district court's ruling that application of the Health Impact Fee to the Settling Defendants' products would violate the federal and state

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[8] *See also* Governor Tim Pawlenty's *Amicus* Br. ("Gov.'s Br.") at 11 ("The full and unfettered exercise of the state's police powers is tempered by the state's obligation to comply with the contracts clauses." (quotation omitted)).

Contracts Clauses. *See* State's Br. at 21-22. Nor could it, in view of the well-settled authority making clear that the requirements of a Contracts Clause violation are satisfied here. Only the Governor argues to the contrary. As the district court correctly ruled, the Governor's arguments are refuted by well-settled precedent, as well as common sense.[9]

To establish a Contracts Clause violation under both the Minnesota and United States Constitutions, a party must prove (1) the existence of a contract; (2) the impairment of an obligation of that contract by a state law; and (3) that the impairment is not a necessary and reasonable means to a legitimate end of protecting the vital interests of the community. *See U.S. Trust Co.*, 431 U.S. at 25; *Baltimore Teachers Union v. Mayor of Baltimore*, 6 F.3d 1012, 1015 (4th Cir. 1993); *Christensen v. Minneapolis Mun. Employees Ret. Bd.*, 331 N.W.2d 740, 750-52 (Minn. 1983); *State ex rel. Hatch v. Employers Ins. of Wausau*, 644 N.W.2d 820, 833 (Minn. Ct. App. 2002). Each of these elements is satisfied here:

First, the term "contract" in the Contracts Clause "is used ··· in its ordinary sense, as signifying the agreement of two or more minds, for considerations proceeding from one to the other, to do or not do certain acts." *La. ex rel. Folsom v.*

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[9] As a threshold matter, this Court should not reach these Contracts Clause defenses because they are raised by the Governor, who, as a nonparty to this appeal, cannot raise issues for this Court to review. *See City of Minneapolis v. Church Universal & Triumphant*, 339 N.W.2d 880, 882 n.3 (Minn. 1983) (holding that amicus curiae could not raise issue on appeal that was not raised by parties to action) (citing *State v. Applebaums Food Markets, Inc.*, 106 N.W.2d 896, 901 (Minn. 1960)); *State v. Fingal*, 666 N.W.2d 420, 423 n.3 (Minn. Ct. App. 2003) (same). The Governor argues other points that the State has not raised in its appeal. *See, e.g., supra* at 30 (Governor alone argues that the Health Impact Fee could be collected from retailers and consumers). None of these arguments is properly before this Court.

City of New Orleans, 109 U.S. 285, 288 (1883). Here, the Court found, and no one disputes, that the Settlement Agreement is a "contract" subject to the Contracts Clause. (App. 14.)

Second, the Health Impact Fee substantially impairs the contractual relationship between the State and Settling Defendants. *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977), is squarely on point. There, New Jersey had repealed a statutory covenant with bondholders. While "no one c [ould] be sure precisely how much financial loss the bondholders suffered" from the covenant's repeal, the Court held that its "repeal totally eliminated an important security provision and thus impaired the obligation of the State's contract." *Id.* at 19. Whereas the statute in *United States Trust* merely affected the security provisions of a bond, here, the Health Impact Fee eliminates the essence of the parties' bargain: The only tangible benefit that the Settling Defendants received was a release of all future liabilities for reimbursement of health care costs that the State attributes to tobacco use. The Health Impact Fee therefore substantially impairs the contractual obligations of the Settlement Agreement.

Indeed, it is well-settled that a State substantially impairs its contract where, as here, it enacts legislation that nullifies the primary financial benefit that the State provided to another contracting party. For example, in *Murray v. City of Charleston*, 96 U.S. 432 (1877), the City of Charleston, South Carolina, had issued bonds at a fixed six percent rate of interest. When this rate later became above-market, thus making the contract no longer as beneficial to the City, the City sought to tax the bondholders on the interest collected in an amount that would reduce the effective rate of interest to four percent. The United States Supreme Court held that this attempt to nullify the contracting party's financial benefit by levying a tax was an unconstitutional impairment of contract barred by the Contracts Clause. *Id.* at 448. As the Court put it:

> In substance, [Charleston] say[s] to the creditor: "True, our assumption was to pay you quarterly a sum of money equal to six percent per annum on the debt we owe you. Such was our express engagement. But we now lessen our obligation. Instead of paying all the interest to you, we retain a part for ourselves [by operation of a newly enacted tax]."

Id. at 443.[10] Like the City in *Murray*, the State here has sought to nullify, through subsequent legislation, the financial benefit provided to the Settling Defendants. The State's Health Impact Fee thus substantially impairs the Settling Defendants' contract.

The Governor (but not the State) argues that there is no impairment because the cost of the Health Impact Fee is ultimately passed on to consumers through higher cigarette prices. *See* Gov.'s Br. at 17-18. But, whether the cost of the Fee is ultimately passed on by distributors to retailers and by retailers to consumers is irrelevant to determining whether the statute impairs the Settling Defendants' contract with the State. "An impairment of a public contract is substantial if it deprives a private party of an important right" or "thwarts performance of an essential term." *S. Cal. Gas Co. v. City of Santa Ana*, 336 F.3d 885, 890 (9th Cir. 2003); *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 246 (1978) (Minnesota statute violated contract clause by "substantially modif[ying]" a "basic term" of a contract); *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 19 (1977) (statute unconstitutionally impaired contract because it "totally

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[10] The Supreme Court has continued to recognize and reaffirm *Murray v. City of Charleston* in recent cases. *See, e.g.*, *Winstar*, 518 U.S. at 913; *U.S. Trust Co.*, 431 U.S. at 24. A consistent result was reached by this Court in *In re Hennepin Cty 1986 Recycling Bond Litig.*, 540 N.W.2d 494 (Minn. 1995).

eliminated ... important security provision" of the agreement). ...re, the enforcement of the Health Impact Fee deprives the Settling Defendants of the essential benefit of their bargain - the release of "liabilities of any nature whatsoever" including "statutory" with respect to health care costs associated with tobacco.

Third, the Health Impact Fee is not a "necessary" and "reasonable" means to serve an important public purpose so as to justify the impairment of the Settlement Agreement. *See Allied Structural Steel*, 438 U.S. at 244 (an impairment is not justified, even for an important public purpose, if is it is not "reasonable" and "necessary" for that purpose). Where, as here, the State itself is a party to the contract that subsequent legislation impairs, more stringent scrutiny applies, and in such circumstances courts have almost invariably found the state's justification insufficient. *See, e.g., Energy Reserves Group, Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 412 n.14 (1983) ("When a State itself enters into a contract, it cannot simply walk away from its financial obligations. In almost every case, the Court has held a governmental unit to its contractual obligations when it enters financial or other markets."); *Allied Structural Steel*, 438 U.S. at 244 n.1 5 ("[I]mpairments of a State's own contracts ··· face more stringent examination under the Contracts Clause than would laws regulating contractual relationships between private parties."); *S. Cal. Gas*, 336 F.3d at 897 ("In the last thirty-five years, no Ninth Circuit or Supreme Court case has found a statute or ordinance necessary when the law in question altered a financial term or an agreement to which a state entity was a party.").

Once again, only the Governor argues that the Health Impact Fee's impairment of the Settlement Agreement is justified, citing the Fee's purposes of "reduc [ing] tobacco use, especially by youth" and "offset[ing] .... the state's tobacco related medical costs." Gov.'s Br. at 12. Once again, his argument is refuted by the well-settled authority that

makes clear that the impairment here is neither "reasonable" nor "necessary" to fulfill either of these purposes.

First, "an impairment is not a reasonable one if the problem sought to be resolved . . . existed at the time the contractual obligation was incurred." *S. Cal. Gas Co.*, 336 F.3d at 895 (quotation and citation omitted); *see U.S. Trust Co.*, 431 U.S. at 31-32 (impairment found not reasonable since the problem addressed was "not a new development," but rather was "well-known" at the time of contract). The health effects of tobacco use and attendant health care costs existed at the time of the Settlement Agreement, forming the very basis of the State's suit. (Supp. App. 110.) The Governor, himself, concedes that tobacco use, especially by youth, has been a "persistent" problem that the State has sought to address as far back as 1985. Gov.'s Br. at 18-19. The Governor therefore cannot rely on these two preexisting purposes to justify the impairment of the Settlement Agreement.

Second, even "reasonable" means to achieving an important public policy must be "necessary" to that purpose to withstand Contracts Clause scrutiny. *See Allied Structural Steel*, 438 U.S. at 244. Put differently, the impairment must be "essential" to the public purpose such that there are no viable "alternative means of achieving . . . [the] goals" absent impairment. *U.S. Trust Co.*, 431 U.S. at 30. The impairment here is not "necessary" to fulfill the two purported goals. *Any* legislation that increases the price of tobacco would further the purpose of reducing smoking, meaning the impairment here is not "essential" to fulfilling that goal. Likewise, *any* legislation that raises revenue will help offset State health care costs from tobacco. In this regard, the United States Supreme Court has flatly rejected the argument that simple revenue-raising (irrespective of the money's intended use) can make an impairment necessary. "A governmental entity can always find a use for extra money . . . . If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public

purpose, the Contract Clause would provide no protection at all." *U.S. Trust Co.*, 431 U.S. at 26.

In sum, enforcement of the Health Impact Fee with respect to the Settling Defendants' products eliminates the Settling Defendants' main benefit under the contract and thus violates the Contracts Clauses of the Minnesota and United States Constitutions.[11]

III. None of the Defenses Invoked by the State - "Unmistakability," Separation of Powers, and Article X, Section 1 of the Minnesota Constitution - Applies Here or Excuses the State's Breach.

Unable to avoid the plain language of the Release, the State invokes two legal doctrines and a constitutional provision that supposedly render the Release unenforceable: the unmistakability doctrine, the separation of powers, and Article X, Section 1 of the Minnesota Constitution. While we address these arguments in detail below, the short answer to all of these arguments is that they rely on the same false premise -- that Settling Defendants claim that the State has

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[11] Equally meritless is the Governor's proposal that the Court rewrite the statute to require consumers and/or retailers to pay the Health Impact Fee instead of distributors. *See* Gov.'s Br. at 14-16. The Health Impact Fee statute expressly requires that distributors pay the fee. (App. 34.) The statute also adopts the preexisting enforcement mechanism for collecting the cigarette excise and gross receipts tax, which requires that distributors purchase and affix a stamp to each pack sold. (App. 34.) *See* Minn. Stat. § 297F.08(1) & (7). As the district court explained, the Health Impact Fee "is imposed upon and collected from the *distributors* of tobacco products. It is they who are statutorily commanded to pay the [Health Impact Fee] and their failure to do so subjects them to license revocation." (App. 13-14.) (emphasis added) Indeed, retailers and consumers would possess unstamped cigarettes only if they were to hold cigarettes that did not go through distributors at all; in the case of Settling Defendants' products, this would occur only in the case of contraband cigarettes. *See* Minn. Stat. § 297F.21(1); Minn. Stat. § 297F.01.

"contracted away" its power to legislate. *See* State's Br. at 23-26; Gov.'s Br. at 5-7. But that is not what occurred here, and it is not what the Settling Defendants claim. Rather, in return for massive payments *forever,* the State granted the Settling Defendants a Release from all liabilities -- past, present, and future; legal, equitable, and statutory -- that fall within the language of the Release. The State thereby assumed the risk that in the future it would not be able to impose new liabilities for the State's smoking-attributable health care costs beyond the liability created by the Settlement Agreement. Such an assumption of risk occurs whenever the State enters into a contract - the State assumes the risk that it will not be able to enforce future legislation that would undermine its prior contract. *See Winstar*, 518 U.S. at 881. If the law were otherwise, the State's contractual obligations could always be overridden by legislative fiat. Parties would not enter into contracts with the State if they faced such a risk of unilateral repudiation, and that would be contrary to public policy and the State's own interests.

"The state is bound, like any other party is bound, to the contracts to which it freely and knowingly enters, and from which it benefits." (App. 14.) *See Chun King Sales, Inc. v. County of St. Louis*, 98 N.W.2d 194, 200 (Minn. 1959) ("[W]hen the state enters into a contract··· its rights and liabilities are the same as a private person."); *Winstar*, 518 U.S. at 887 n.32 ("[T]he Government is ordinarily treated just like a private party in its contractual dealings."). A government cannot use its legislative power to alter, modify, obstruct, or violate a contract into which it has previously entered. *See, e.g., Kimberly Assocs. v. United States*, 261 F.3d 864, 870 (9th Cir. 2001) ("[T]he government in its private contracting capacity cannot exercise sovereign power for the purpose of altering, modifying, obstructing or violating the particular contracts into which it had entered with private parties." (quotation and citation omitted)); *see also Grass Valley Terrace v. United States*, 51 Fed. Cl. 436, 441 (2002) ("[A]lthough the act at issue may not formally

target particular transactions, the government is still not relieved of its contractual obligations if 'a measure's impact nonetheless falls substantially upon the government's contracting partners.'" (quoting *Winstar*, 518 U.S. at 902-03)); *Alaska Pulp Corp. v. United States*, 48 Fed. Cl. 655, 659 (2001) ("The archetypical repudiation . . . occurs when one party to a contract attempts to unilaterally alter the contract or to condition his performance on terms that were not part of the bargain . . . . The result is no different where the government as a party to the contract commits this same sin through subsequent legislation." (citations omitted)). As we explain below, these well-settled principles defeat each of the State's proffered defenses.

A. The Unmistakability Doctrine Does Not Apply.

The State first invokes the "unmistakability doctrine," which provides that, where the government enters into a contract that purports to waive its sovereign powers, the waiver will not be enforced unless it is stated in unmistakable terms. *See Winstar*, 518 U.S. at 872; *Kimberly . socs.*, 261 F.3d at 869. But, as the district court held, the unmistakability doctrine does not apply here, because the "Settlement Agreement involves neither the eradication or usurpation of its sovereign power." (App. 11)[12] Instead, the Settlement Agreement simply grants the Settling Defendants a release from future liabilities with respect to health care costs that the State attributes to smoking. As noted above, by entering into this agreement, the State assumed the risk that future legislation would create additional "liabilities of any

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[12] The State's argument that the district court improperly "interpreted the release as surrendering sovereign powers without applying the doctrine," State's Br. at 26 & 26 n.12 (emphasis removed), misreads the district court's opinion. The district court found that the Settlement Agreement "involves neither the eradication or usurpation of [the State's] sovereign power" and therefore the doctrine does not apply. (App. 16.)

nature whatsoever" that would fall within the Release and thus be unenforceable as to the Settling Defendants' products.

In this respect, this case is indistinguishable from *United States v. Winstar Corp.*, 518 U.S. 839. There, the United States Supreme Court refused to apply the unmistakability doctrine where the contract at issue did not purport to surrender generally the taxation power or some other sovereign power. *See id.* at 887. As the Court explained, "[s]o long as . . . a contract is reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of [the claimed sovereign] power, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to guard against, and there is no reason to apply it." *Id.* at 880.

As in *Winstar,* the contract here did not require the State to surrender a sovereign power. Rather, the State granted a release to the Settling Defendants from past, present, and *future* liabilities for health care costs. In doing so, the State assumed the risk that it would have to forgo the enforcement of greater liabilities on the Settling Defendants that later legislative acts may otherwise have allowed. *See id.* at 881; *Centex Corp. v. United States*, 395 F.3d 1283, 1305 (Fed. Cir. 2005). The State's subsequent enactment of such legislation neither nullifies the Release nor triggers the unmistakability doctrine; it is precisely the type of future liability from which the Release was designed to protect the Settling Defendants.

Moreover, even if the unmistakability doctrine applied (which it does not), the doctrine is satisfied where, as here, there is a clear statement of the government's obligation. *See Winstar*, 518 U.S. at 875. The Settlement Agreement explicitly releases and discharges the Settling Defendants from "liabilities of any nature whatsoever" for health care costs allegedly related to smoking, including "statutory" liability. (App. 5152.) This clear and unmistakable agreement would satisfy the unmistakability doctrine even if

it applied. *See, e.g., Gen. Dynamics Corp. v. United States*, 47 Fed. Cl. 514, 547 (2000).

B. Separation of Powers Principles Are Not Violated by Enforcement of the Settlement Agreement.

The State's separation of powers argument, like its unmistakability argument, is premised on the misconception that the district court's opinion found the Settlement Agreement to work some "surrender" of sovereign, legislative power. As discussed above, the district court's opinion contains no such finding. Rather, the plain language of the Settlement Agreement provides the Settling Defendants and their distributors with a release from enforcement of such a subsequent imposition of liability as to their products.

The Attorney General had authority to enter into such a release and to bind the State in all of its manifestations. As this Court explained nearly twenty years ago, "[a]s the chief law officer of the state, the attorney general possesses all of the powers inherent in that office at common law .... The attorney general may institute, conduct, and maintain all such actions and proceedings as he deems necessary for the enforcement of the laws of this state, the preservation of order, and the protection of legal right." *Humphrey ex rel. State v. McLaren*, 402 N.W.2d 535, 539 (Minn. 1987) (citation omitted). The common law authority to "conduct" and "maintain" such actions on behalf of the State as the Attorney General sees fit logically includes the authority to settle such actions on behalf of the State on terms that the Attorney General deems appropriate.

In addition to this common law authority, the Attorney General is vested with statutory authority under Minn. Stat. § 8.31 to investigate, prosecute, and settle State claims. Pursuant to this statutory directive, the Attorney General has regularly entered into court-approved settlements involving the State's complete and full release of various claims. *See, e.g., In re S. Minn. Ready Mix, Inc.*, No. CX89 10963, 1989 WL 265297 (Minn. Dist. Ct. May 11, 1989); *In re*

Eschenbach Optik of Am. Inc., No. C2-92-809, 1992 WL 48976 (Minn. Dist. Ct. Jan. 22, 1992); *In re Dep't 56*, No. C9-92-287, 1992 WL 48974 (Minn. Dist. Ct. Jan. 9, 1992). The district court specifically relied on this statutory provision in approving the Settlement Agreement. (App. 73.)

Consistent with this broad common law and statutory authority, the Attorney General brought suit on behalf of the "State of Minnesota." The resulting Settlement Agreement and Release was entered into by the "State of Minnesota" and not just the Attorney General's Office or the Executive Branch . (App. 62.) Likewise, the Release is the "State of Minnesota's Release and Discharge," not the Attorney General's. (App. 50.) In entering into the Release, the Attorney General had the authority to bind, and did bind, the State in all of its manifestations. A contrary rule would render any settlement agreement entered into by the Attorney General on behalf of the State unenforceable and subject to unilateral nullification by the Legislature.

To the extent that any doubt remains, the Settlement Agreement itself clearly defines the "State of Minnesota" to include *all* members of the Executive Branch.[13] Thus, even if the Settlement Agreement did not bind the entire State (which it does), no member of the Executive Branch could *enforce* the Health Impact Fee without violating the agreement. The Settlement Agreement provides that the Release "shall be a complete defense to any civil action or proceeding" brought by the State that seeks to recover the State's smoking-related health care costs. (App. 52.) Any effort by the Executive

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[13] The Settlement Agreement defines the "State of Minnesota" to include, but not be limited to, "its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions." (App. 51.) This definition encompasses every official in the Executive Branch.

Branch to enforce the Health Impact Fee against the Settling Defendants and their distributors would therefore give rise to the "complete defense" of the Release. Indeed, the State has conceded that if the Legislature were to create a new cause of action for recovery of the State's health care costs, the Release would apply to the Executive Branch's attempt to bring suit under such a provision, even though the legislation itself may be valid in all respects. *See* State's Mem. of Law in Opp. to Defs.' Mot. at 16. There is no difference between that situation and this case.

Finally, even if the Attorney General lacked authority to enter into the Release (which he did not), the State's separation of powers argument would fail because the Legislature acquiesced in and subsequently ratified the Settlement Agreement. (App. 12, 15.) As this Court explained in *Butler v. Hatfield*, 152 N.W.2d 484 (Minn. 1967), "[t]he legislature may ratify an unauthorized contract entered into by one of the state officials on its behalf even though in excess of his authority." *Id.* at 493; *see also Yaeger v. Giguerre*, 23 N.W.2d 22, 25 (Minn. 1946) ("[Wlhatever acts public officials may do or authorize to be done in the first instance may subsequently be adopted or ratified by them with the same effect as though properly done under previous authority.").

As the district court held, here the Legislature ratified the Settlement Agreement in two ways. First, the Legislature ratified the Settlement Agreement "by its conduct of actively employing settlement funds to achieve legislative purposes" over more than seven years and never once questioning its validity. (App. 12.) *See, e.g.*, *Butler*, 152 N.W.2d at 496 (prior contract with an architect entered into on behalf of the State by an administrative official "was ratified and given contractual validity" when the Legislature enacted a bill appropriating funds to pay for construction of the buildings that the architect had designed); *see also Hamilton v. Dillin*, 88 U.S. 73, 96-97 (1874) (holding that Congress ratified President's collection of fee when it enacted legislation

referring to the fee and directing that all funds arising from the fee "be paid into the treasury"). As a result, the State has ratified the Settlement Agreement and cannot now dispute that is binding and enforceable. (*Id.*)[14]

Second, the Legislature ratified the Settlement Agreement by passing a "fee in lieu of settlement" on nonsettling tobacco companies that specifically references and endorses the Settlement Agreement. *See* Minn. Stat. § 297F.24. (App. 12 n.1, 15.) In that statute, the Legislature provided that a nonsettling tobacco manufacturer could avoid a fee that would otherwise apply to its products if it "enter[ed] into an agreement with the state on similar terms" to the Settlement Agreement here. *See Council of Indep. Tobacco Mfrs. of Am. v. State*, 685 N.W.2d 467, 471 (Minn. Ct. App. 2004) (appeal pending).

In sum, the Attorney General clearly had the authority to enter into the Settlement Agreement and in doing so did not surrender the powers of the Legislature. Moreover, ***39** any potential separation of powers argument fails in light of the Legislature's subsequent ratification of the Settlement Agreement.

C. The Settlement Agreement Does Not Surrender the Power of Taxation or Any Other Legislative Power.

As with the unmistakability doctrine and separation of powers, the State's argument based on Article X, Section 1 of the Minnesota Constitution asserts that the Settlement Agreement cannot "contract away" a Legislative power - this

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[14] *See also City of Minneapolis v. Republic Creosoting Co.*, 201 N.W. 414, 418 (Minn. 1924) ("It has been repeatedly held, and we think with good reason, that when a party has accepted the benefits of a contract··· he should not be permitted to question the validity of it."); *Mesaba Aviation v. County of Itasca*, 258 N.W.2d 877, 880 (Minn. 1977); *In re Labelle's Trust*, 223 N.W.2d 400, 409 (Minn. 1974).

time, the power to tax. *See* State's Br. at 30-33. But once again, Settling Defendants do not contend, nor did the district court find, that the State surrendered its power to tax by entering into the Settlement Agreement. While Article X, Section 1 prevents the State from expressly contracting away its power of taxation, it does *not* give the State a license to void any contractual obligation it desires as long as it finds a way to do so under its "taxing" power. As this Court has recognized, there is no constitutional prohibition against the State assuming a contractual obligation that has an *indirect* effect on the subsequent exercise of its taxation power. *See Naftalin v. King*, 90 N.W.2d 185, 191 (Minn. 1958) ("Although the legislature may not surrender, suspend, or contract away the state's power of taxation . . . there is nothing in the constitution which prohibits the legislature from irrevocably binding its taxing power to provide the funds necessary to fulfill the state's contractual obligations.").

As the district court held, the Release in question here "involves neither the eradication or usurpation of its sovereign power" to tax, but instead only the State's "assent to a contract, of the nature and type, which the state enters into every day in a variety of situations." (App. 16.) At most, the Release has an indirect effect on the Legislature's subsequent exercise of its taxing power and therefore does not violate Article X, Section 1. That fact distinguishes this case from *Anderson v. State*, 435 N.W.2d 74 (Minn. Ct. App. 1989). *See* State's Br. at 32-33. A contrary interpretation would result in the State being unable to enter into any binding financial contract because the Legislature would always have the unilateral power to nullify its terms through the taxing power.

Regardless, the Minnesota Constitution's restriction on contracting away the power to tax is wholly inapplicable here for another reason as well: the Health Impact Fee is in fact a "fee" and not a "tax." As the district court found, "[t]he totality of all circumstances, . . . as well as the statutorily

expressed purpose, all require the conclusion that the [Health Impact Fee] is a fee." (App. 15.)

In determining whether an enactment is a tax or a fee, a court must look at the statutory language, purpose, and administration. *See, e.g., Country Joe, Inc. v City of Eagan*, 560 N.W.2d 681, 686 (Minn. 1997) (noting purpose and administration of statutory exaction in determining whether it was tax or fee); *S.C. ex rel. Tindal v. Block*, 717 F.2d 874, 887 (4th Cir. 1983) (determining that a statute is a fee as opposed to a tax because "[t]he clear language and structure of the 1982 amendment indicates that its primary purpose is regulation"). Here, (1) the statutory purpose behind the Health Impact Fee, (2) the way it is structured and administered, (3) the rights it implicates, and (4) the choice of the Legislature and Executive to label it a fee all demonstrate that the Health Impact Fee is a fee and not a tax.

First, the stated statutory purpose of the Health Impact Fee demonstrates that it is a fee. The district court correctly held that "the key to determining whether or not a particular item is a fee or a tax is whether or not it has a direct relationship to the costs which the reimbursement [fee] seeks" to recoup. (App. 15.) *See Country Joe*, 560 N.W.2d at 685; *accord, e.g., Okeson v. City of Seattle*, 78 P.3d 1279, 1286 (Wash. 2003) ("[A] regulatory fee raises money . . . *to pay for or regulate the burden those who pay have created.*" (emphasis added)). Here, the stated purpose of the Health Impact Fee was to reimburse the State for specific health care costs caused by or associated with tobacco use. (App. 33.) Indeed, the amount of the fee "was arrived at based on the impact of tobacco use o[n] the state's public funded health programs, such as Medical Assistance, GAMC and Minnesota Care." (Supp. App. 167.) As the district court concluded, "the purpose of the legislation was to seek governmental reimbursement for the costs associated with tobacco which

distinguishes the [Health Impact Fee] from a tax and makes it a fee." (App. 15.)[15]

The fact that the Health Impact Fee was enacted to reimburse the State for tobacco-related expenses and not simply to raise revenue is underscored by the statute in which it was passed. The Health Impact Fee was included within the "Omnibus Health and Human Services Bill" - a bill dedicated solely to health care. *See generally* 2005 Minn. H.F. 139. Tellingly, the Legislature simultaneously enacted a separate "Omnibus Tax Bill" that was dedicated solely to taxes. *See* 2005 Minn. H.F. 138. If the Health Impact Fee were, in fact, a tax, its inclusion in a health care bill and not in a simultaneously passed tax bill would run afoul of Minnesota's constitutional single subject requirement. *See* Minn. Const. art. IV, section 17 ("[n]o law shall embrace more than one subject, which shall be expressed in its title."). The district court correctly interpreted the statute in a manner that avoided conflict with the Constitution. *In re Risk Level Determination of CM.*, 578 N.W.2d 391, 396 (Minn. Ct. App. 1998) (A court is obligated to adopt interpretation of statute that "stands in harmony with the Constitution, even if the alternative

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[15] Instead of addressing the purpose of the Health Impact Fee, the State argues that simply because the Health Impact Fee raises revenue, it must be a tax. *See* State's Br. at 36-44. But both fees and taxes raise revenue; as explained above, the pertinent question is whether the revenue is used for the general welfare of the public or for some specific purpose. *See Country Joe, Inc.*, 560 N.W.2d at 686 (in holding that exaction was not a fee, court stated "we find it significant that revenues collected from the road unit connection charge are not earmarked in any way to fund projects necessitated by new development"); *Farmers Ins. Group v. Comm'r of Taxation*, 153 N.W.2d 236, 240 (Minn. 1967); *Tindal*, 717 F.2d at 887; *Okeson*, 78 P.3d at 1286 ("It is a misnomer to simply ask whether the charges raise revenue, because both taxes and regulatory fees raise revenue.").

construction might otherwise seem a more accurate reflection of legislative intent." (citation omitted)).

Second, the Health Impact Fee is structured and administered as a fee. Courts have found the creation of a special fund significant in determining that an exaction is a fee rather than a tax. *See, e.g., San Juan Cellular Tel. Co. v. Pub. Servs. Comm'n*, 967 F.2d 683, 685 (1st Cir. 1992) (noting that one feature of a fee, unlike a tax, is that it is placed into a special fund to defray costs). In fact, in *Country Joe, Inc. v. City of Eagan*, 560 N.W.2d 681, this Court, in determining that an exaction was a tax rather than a fee, stated "we find it significant that revenues collected from the road unit connection charge are not earmarked in any way to fund projects necessitated by new development, but instead fund all major street construction, as well as repairs of existing streets." *Id.* at 686.

Here, money generated by the Health Impact Fee does not go to the general Treasury, but instead goes into a special fund called the "Health Impact Fund" for use in reimbursing the State for costs associated with tobacco use. (App. 33.) As the district court described, "the Human Services Commissioner must annually certify to the Finance Commissioner the '. . . tobacco use attributable costs.' Upon receipt of that certification, the Finance Commissioner is then mandated to transfer from the [Health Impact Fee] fund to the general fund an amount sufficient to offset the certified expenditures." (App. 13 (quoting App. 33).) In other words, the Health Impact Fee must be used to cover the health care costs that the State believes it has incurred in a given year as a result of tobacco use. This is the very essence of a fee. *Country Joe*, 560 N.W.2d at 686. As the district court concluded, "[t]he mechanism by which the funds are collected by the $.75 [Health Impact Fee] also militate[s] against finding that it is a tax, rather than a fee." (App. 13.)

In this regard, *San Juan Cellular Telephone Co. v. Public Services Commission*, 967 F.2d 683, is directly on

point. There, the court concluded that a statute was a fee when (1) the money was used to defray expenses generated by the industry against which the fee was levied, (2) a regulatory agency assessed the fee, and (3) the fee was deposited into a special fund. *Id.* at 686. As in *San Juan,* the State here enacted the Health Impact Fee to defray its health care costs attributable to smoking and to discourage the use of tobacco, required a regulatory agency to assess such costs, and deposited the monies in a special fund. As a regulatory measure enacted for a specified purpose, the Health Impact Fee is a fee and not a tax. *See also State v. Hovorka*, 110 N.W. 870 (Minn. 1907); *Ramaley v. City of St. Paul*, 33 N.W.2d 19, 22 (Minn. 1948).

The State relies on the Washington Supreme Court's decision in *Okeson v. City of Seattle*, 78 P.3d 1279, for the proposition that the segregation of revenue in a separate fund does not make an enactment a fee. Although in that case there was a special fund, there was no regulatory purpose for the exaction, which was instead a general revenue raising mechanism. *Id.* at 1286-87. Accordingly, the court noted that the creation of a fund weighed in favor of the finding of the law to be a fee but did not mandate such a finding. *Id.* Other factors militated in favor of characterizing the exaction a tax. Here, however, the Health Impact Fee not only goes into a separate fund, but also serves the express regulatory purpose of requiring an industry to reimburse the State for the alleged burden (health care expenses) created by that industry. *See, e.g., San Juan Cellular Tel. Co.*, 967 F.2d at 685. Indeed, the *Okeson* court specifically recognized that a regulatory fee is one that "raises money to ··· pay for or regulate the burden those who pay have created." *Id.* at 1286. *Okeson* thus supports, rather than undercuts, the argument that the Heath Impact Fee is a "fee" and not a "tax."

Third, the Health Impact Fee implicates the "right or privilege to engage" in the business of tobacco-product distribution, and is therefore a fee. *See* State's Br. at 36 (quoting *Ramaley v. St. Paul*, 33 N.W.2d 19, 21-22 (Minn.

1948)). Distributors must pay the fee in order to receive stamps, which must be affixed to tobacco products prior to sale. (App. 33.) (adopting the enforcement mechanism of chapters 270C and 297F) As the State admits, failing to affix the stamps prior to sale can result in the revocation of the distributor's license to sell tobacco products in the State. *See* State's Br. at 38, 39 n.23; App. 34; Minn. Stat. § 297F.03(1) & (7); *see also* Gov.'s Br. at 19. These provisions make clear that the Health Impact Fee implicates "the licensing or regulation of the [cigarette] business," such that it is a fee. *Ramaley*, 33 N.W.2d at 21.

Finally, it bears emphasizing that the legislation specifically labels the Health Impact Fee as a fee. (App. 33.) When proposing the Health Impact Fee, to demonstrate that it was legally a "fee" and not a "tax," the Governor released a publication of the Minnesota Department of Revenue entitled "Use of Fees vs. Taxes." (Supp. App. 171.) In this publication, the Department of Revenue distinguished the features of fees from those of taxes, specifically noting that a fee "approximate[s] the costs incurred by, or imposed on, government" by an industry. (*Id.*) After debate and due consideration, the Legislature agreed, passing the Health Impact Fee as a "fee." (App. 33.) That legislative determination likewise makes clear that the Health Impact Fee is a fee and not a tax and that, therefore, Article X, Section I would not apply here even if the Settlement Agreement purported to surrender the State's taxation power (which it does not).

CONCLUSION

Respondents Settling Defendants and Defendants' Distributors respectfully request that this Court affirm the judgment of the district court.

Dated: March 2, 2006

Respectfully submitted,

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APPENDIX H -- MOTION FOR ENFORCEMENT OF SETTLEMENT AGREEMENT BEFORE THE MINNESOTA DISTRICT COURT

STATE OF MINNESOTA

COUNTY OF RAMSEY DISTRICT COURT

SECOND JUDICIAL DISTRICT

THE STATE OF MINNESOTA, BY HUBERT H. HUMPHREY III, ITS ATTORNEY GENERAL,

and

BLUE CROSS AND BLUE SHIELD OF MINNESOTA,

Plaintiffs,

vs.

PHILIP MORRIS USA, INC., R.J. REYNOLDS TOBACCO COMPANY, BROWN & WILLIAMSON TOBACCO CORPORATION, B.A.T. INDUSTRIES P.L.C., BRITISH-AMERICAN TOBACCO COMPANY LIMITED, BAT (U.K. & EXPORT) LIMITED, LORILLARD TOBACCO COMPANY, THE AMERICAN TOBACCO COMPANY, LIGGETT GROUP, INC., THE COUNCIL FOR TOBACCO RESEARCH-U.S.A., INC., and THE TOBACCO INSTITUTE, INC.

Case Type: Other Civil

Court File No. C1-94-8565

DEFENDANTS' AND DEFENDANTS' DISTRIBUTORS' NOTICE OF MOTION AND MOTION FOR ENFORCEMENT OF SETTLEMENT AGREEMENT

PLEASE TAKE NOTICE that on September ____, 2005, ___:00 __.m., before the Honorable Michael F. Fetsch, at the Ramsey County District Court, Philip Morris USA, R.J.

Reynolds Tobacco Company ("RJRT"), and Lorillard Tobacco Company ("Lorillard") (collectively referred to as the "Settling Defendants") and the distributors of Settling Defendants' products, A.H. Hermel, Candy & Tobacco Co.; Henry's Foods, Inc.; Sandstrom's, Inc.; Johnson Candy and Tobacco Company of Brainerd, Inc.; M. Amundson Cigar & Candy Company, LLP; The Watson Companies, Inc.; Granite City Jobbing Company, Inc.; Minter-Weisman Co., and Segal Wholesale, Inc. ("Distributors") will bring a motion for an order enforcing the Settlement Agreement and Stipulation for Entry of Consent Judgment executed with the State of Minnesota entered in this action and approved by this Court on May 8, 1998. In support of this Motion, the Settling Defendants and their Distributors state as follows:

1. On May 8, 1998, the Settling Defendants entered into a Settlement Agreement and Stipulation for Entry of Consent Judgment (the "Settlement Agreement") with the State of Minnesota to resolve litigation brought against the Settling Defendants and other tobacco product manufacturers by the State and to resolve any past, current, or future claims the State may have for recovery of health care costs allegedly attributable to tobacco use or exposure. On May 8, 1998, this Court signed a Consent Judgment approving the Settlement Agreement, and on May 19, 1998, the Court Administrator entered judgment.

2. The Settlement Agreement obligates the State to

> release and forever discharge all Defendants and their . . . distributors . . . from any and all liabilities whatsoever . . . whether legal, equitable or statutory ("Claims") that the State of Minnesota . . . ever had, now has or hereafter can, shall, or may have, as follows:
>
> . . . .

> b. for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

Settlement Agreement § III.B (the "Release Provision").

3. The Settlement Agreement further obligates the State "to support the integrity and enforcement of the terms of this Settlement Agreement." Settlement Agreement § V.I (the "Express Warranty of Good Faith and Fair Dealing").

4. In signing the Settlement Agreement, the State agreed that the Settlement Agreement "shall constitute a valid and binding contractual obligation, enforceable in accordance with its terms." Settlement Agreement § V.A. The Settlement Agreement requires that "any disputes under this Settlement Agreement, including without limitation any claims for breach or enforcement of this Settlement Agreement, [must be presented] exclusively to [the District Court of Ramsey County, Second Judicial District]," which "retain[s] jurisdiction for the purposes of implementing and enforcing this Settlement Agreement." Settlement Agreement § I.A.

5. Effective August 1, 2005, the State imposed a "Tobacco Health Impact Fee" (the "HIF") on "cigarette distributors and tobacco products distributors to recover for the state health costs related to or caused by tobacco use." *See* Minn. H.F. 139 (2005 Special Sess.), Art. 4 § 2(1). The statute contains no exemptions for products manufactured by the Settling Defendants.

6. The imposition of the HIF on the Settling Defendants' products would violate material terms of the Settlement Agreement, including its Release Provision and its Express Warranty of Good Faith and Fair Dealing. By impairing the State's obligations under the Settlement Agreement, imposition of the HIF would also violate the Contracts Clauses of the Minnesota and United States Constitutions. Minn. Constit. Art. I, § 11 ("[n]o law impairing the obligation of contracts shall be passed.") & U.S. Constit. Art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts.").

7. Due to the State's imminent enforcement of the HIF, the statute's clear violation of the terms of the Settlement Agreement, and the importance of the Constitutional issues raised herein, Settling Defendants and their Distributors respectfully request that the Court consider this motion on an expedited basis, that a hearing be scheduled promptly, and that there be no continuations or delays prior to a prompt ruling on the Motion.

8. For these reasons and for those stated in the accompanying Memorandum of Law, the Settling Defendants and their Distributors move this Court for an Order declaring that the release is applicable to the HIF and serves as a complete bar and defense to any attempt by the State to collect the HIF with respect to Settling Defendants' products. In the alternative, the Settling Defendants and their Distributors move this Court for an Order declaring that the State has breached the Settlement Agreement and ordering compliance with the agreement; and declaring that the HIF violates the Contracts Clauses of the United States and Minnesota Constitutions.

9. This Motion is based upon the Memorandum of Law in Support of Defendants' and Defendants' Distributors' Motion for Enforcement of Settlement Agreement, the

Affidavit of Edward Magarian and attached exhibits, the proposed order, and all the files and pleadings herein.

Dated: August 26, 2005

Respectfully submitted,

PHILIP MORRIS USA

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By: /s/

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APPENDIX I -- SETTLEMENT AGREEMENT AND STIPULATION FOR ENTRY OF CONSENT JUDGMENT

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF RAMSEY

SECOND JUDICIAL DISTRICT

THE STATE OF MINNESOTA, BY HUBERT H. HUMPHREY III, ITS ATTORNEY GENERAL, and BLUE CROSS AND BLUE SHIELD OF MINNESOTA,

Plaintiffs,

vs.

PHILIP MORRIS INCORPORATED, R.J. REYNOLDS TOBACCO COMPANY, BROWN & WILLIAMSON TOBACCO CORPORATION, B.A.T. INDUSTRIES P.L.C., BRITISH-AMERICAN TOBACCO COMPANY LIMITED, BAT (U.K. & EXPORT) LIMITED, LORILLARD TOBACCO COMPANY, THE AMERICAN TOBACCO COMPANY, LIGGETT GROUP, INC., THE COUNCIL FOR TOBACCO RESEARCH-U.S.A., INC., and THE TOBACCO INSTITUTE, INC.,

Defendants.

Civil Case No. C1-94-8565

May 8, 1998

SETTLEMENT AGREEMENT AND STIPULATION FOR ENTRY OF CONSENT JUDGMENT

THIS SETTLEMENT AGREEMENT AND RELEASE ("Settlement Agreement") is made as of the date hereof, by and among the parties hereto, as indicated by their signatures below, to settle and resolve with finality all claims of the State of Minnesota relating to the subject matter of this

action which have been or could have been asserted by the State of Minnesota.

WHEREAS, the State of Minnesota, through its Attorney General Hubert H. Humphrey III, and Blue Cross and Blue Shield of Minnesota, commenced this action on August 17, 1994, asserting various claims for monetary, equitable and injunctive relief on behalf of the State of Minnesota and Blue Cross and Blue Shield of Minnesota against certain tobacco manufacturers and others as Defendants;

WHEREAS, the Defendants have denied each and every one of Plaintiffs' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to Plaintiffs' claims, which defenses have been contested by Plaintiffs;

WHEREAS, the parties hereto wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation of this matter (including appeals from any verdict), the State of Minnesota and the Settling Defendants have agreed to settle this litigation pursuant to terms which will achieve for the State of Minnesota (and thus for the people of the State of Minnesota) significant funding for the advancement of public health, the implementation of important tobacco-related public health measures in Minnesota, as well as funding for national research dedicated to studying and significantly reducing the use of Tobacco Products by youth;

WHEREAS, the State of Minnesota and Settling Defendants have agreed to settle this lawsuit on terms set forth in this Settlement Agreement and Stipulation for Entry of Consent Judgment and the attached Consent Judgment;

WHEREAS, the parties have further greed to jointly petition the Court for approval of the Consent Judgment, on the grounds that settlement would be in the public interest;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the payments to be made by the Settling Defendants, the dismissal and release of claims by the State of Minnesota and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the parties hereto, acting by and through their authorized agents, memorialize and agree as follows:

I. GENERAL PROVISIONS

A. Jurisdiction.

The State and the Settling Defendants acknowledge that this Court has jurisdiction over the subject matter of this action and over each of the parties to this Settlement Agreement, and that this Court shall retain jurisdiction for the purposes of implementing and enforcing this Settlement Agreement. The parties hereto agree to present any disputes under this Settlement Agreement, including without limitation any claims for breach or enforcement of this Settlement Agreement, exclusively to this Court. The Court may, upon the State's application, enter a Consent Judgment in the form attached hereto as Exhibit A. The cumulative terms of this Settlement Agreement and Stipulation for Entry of Consent Judgment, and the attached Consent Judgment, may be referred to for convenience as this "Agreement" or "Settlement Agreement."

B. Voluntary Agreement of the Parties.

The State and the Settling Defendants acknowledge and agree that this Settlement Agreement is voluntarily entered into by all parties hereto as the result of arm's-length negotiations during which all such parties were represented by counsel. The State and Settling Defendants understand that Congress may enact legislation dealing with some of the issues addressed in this Agreement. Settling Defendants and their assigns, affiliates, agents, and successors hereby waive any right to challenge this Agreement or the Consent Judgment, directly or through third parties, on the ground that

any term hereof is unconstitutional, outside the power or jurisdiction of the Court, preempted by or in conflict with any current or future federal legislation (except where non-economic terms of future federal legislation are irreconcilable).

C. Definitions.

For the purposes of this Settlement Agreement and attached Consent Judgment, the following terms shall have the meanings set forth below:

1. "State" or "State of Minnesota" means the State of Minnesota acting by and through its Attorney General;

2. "Blue Cross" means BCBSM, Inc., d/b/a Blue Cross and Blue Shield of Minnesota, and all of its administrators, representatives, employees, directors, officers, agents, attorneys, parents and divisions;

3. "Settling Defendants" means those Defendants in this action that are signatories hereto;

4. "Defendants" means Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, B.A.T Industries P.L.C., British-American Tobacco Company Limited, BAT (U.K. and Export) Limited, Lorillard Tobacco Company, The American Tobacco Company, The Council for Tobacco Research-U.S.A., Inc., and the Tobacco Institute, Inc. and their successors and assigns;

5. "Consumer Price Index" shall mean the Consumer Price Index for All Urban Consumers, for the most recent twelve-month period for which such percentage information is available as published by the Bureau of Labor Statistics of the U.S. Department of Labor.

6. "Court" means the District Court of the State of Minnesota, County of Ramsey, Second Judicial District;

7. "Market Share" means a Settling Defendant's respective share of sales of cigarettes by unit for consumption in the United States during (i) with respect to payments made pursuant to Paragraph II.D. of this Settlement Agreement, the calendar year ending on the date on which the payment at issue is due, regardless of when such payment is made, and (ii) with respect to all other payments made pursuant to this Settlement Agreement, the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made;

8. "Cigarettes" means any product which contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (ii) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (iii) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in subparagraph (i) of this paragraph;

9. "Smokeless Tobacco" means any powder that consists of cut, ground, powdered, or leaf tobacco that contains nicotine and that is intended to be placed in the oral cavity;

10. "Tobacco Products" means Cigarettes and Smokeless Tobacco;

11. "Billboards" includes billboards, as well as all signs and placards in arenas and stadiums, whether open-air or enclosed. "Billboards" does not include (1) any advertisements placed on or outside the premises of retail establishments which sell tobacco products, or any retail point-of-sale; and (2) billboards or advertisements in connection with the sponsorship by the Defendants of any entertainment, sporting or similar event, such as NASCAR,

that appears in the State of Minnesota as part of a national or multi-state tour;

12. "Children" or "youth" means persons under the age of 18;

13. "Depository," unless otherwise specified, means the Minnesota document depository established by the Court's Order dated June 16, 1995. "Depositories" includes both the Minnesota depository and the Guildford, U.K. document depository established by the Court's Order dated September 6, 1995;

14. "Transit Advertisements" means advertising on private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, waiting area, train station, airport or any similar location. "Transit Advertisements" does not include any advertisements placed on or outside the premises of retail establishments licensed to sell Tobacco Products or any retail point-of-sale;

15. "Special State Counsel" means Robins, Kaplan, Miller & Ciresi L.L.P. or a successor, if any; and

16. "Final Approval" means the date on which this Settlement Agreement and the form of State Escrow Agreement are approved by the Court. At the time of such approval, the settlement between the parties is final.

II. SETTLEMENT PAYMENTS

A. Settlement Receipts.

The payments to be made by the Settling Defendants under this Settlement Agreement are in satisfaction of all of the State of Minnesota's claims for damages incurred by the State in the year of such payment or earlier years related to the subject matter of this action, including, without limitation, claims for equitable and injunctive relief, claims for health care expenditures and claims for punitive damages, except that no part of any payment under this Settlement Agreement

is made in settlement of an actual or potential liability for a fine, penalty (civil or criminal) or enhanced damages.

B. Settlement Payments to the State of Minnesota.

Each Settling Defendant severally shall cause to be paid to an account designated in writing by the State of Minnesota in accordance with and subject to paragraph II.E. of this Settlement Agreement, the following amounts: the amount listed for it in Schedule A hereto, such amount representing its share of $240,000,000, to be paid on or before September 5, 1998; pro rata in proportion to its Market Share, its share of $220,800,000, to be paid on or before January 4, 1999; pro rata in proportion to its Market Share, its share of $242,550,000, to be paid on or before January 3, 2000; pro rata in proportion to its Market Share, its share of $242,550,000, to be paid on or before January 2, 2001; pro rata in proportion to its Market Share, its share of $242,550,000, to be paid on or before January 2, 2002; and pro rata in proportion to its Market Share, its share of $121,550,000, to be paid on or before January 2, 2003. The payments made by the Settling Defendants pursuant to this Paragraph shall be adjusted upward by the greater of 3% or the Consumer Price Index applied each year on the previous year, beginning with the payment due to be made on or before January 3, 2000. The payments due to be made by the Settling Defendants pursuant to this Paragraph on or before January 3, 2000, on or before January 2, 2001, on or before January 2, 2002, and on or before January 2, 2003, will also be decreased or increased, as the case may be, in accordance with the formula for adjustments of payments as set forth in Appendix A. The payments due to be made by the Settling Defendants pursuant to this Paragraph on or before September 5, 1998, and on or before January 4, 1999, shall not be subject to inflation escalation and volume adjustments described in the preceding sentences.

In the event that any of the Settling Defendants fails to make any payment required of it pursuant to this Paragraph (a

"Defaulting Defendant") by the applicable date set forth in this paragraph II.B. (a "Missed Payment"), the State of Minnesota shall provide notice to each of the Settling Defendants of such non-payment. The Defaulting Defendant shall have 15 days after receipt of such notice to pay the Missed Payment, together with interest accrued from the original applicable due date at the prime rate as published in the Wall Street Journal on the latest publication date on or before the date of default plus 3%. If the Defaulting Defendant does not make such payment within such 15-day period, the State of Minnesota shall provide notice to each of the Settling Defendants of such continued non-payment. Any or all of the Settling Defendants (other than the Defaulting Defendant) shall thereafter have 15 days after receipt of such notice to elect (in such Settling Defendant's or such Settling Defendants' sole and absolute discretion) to pay the Missed Payment, together with interest accrued from the original applicable due date at the prime rate as published in the Wall Street Journal on the latest publication date on or before the date of default plus 3%. In the event that the State of Minnesota does not receive the Missed Payment, together with such accrued interest, within such additional 15-day period, all payments required to be made by each of the respective Settling Defendants pursuant to this Paragraph shall at the end of such additional 15-day period be accelerated and shall immediately become due and owing to the State of Minnesota from each Settling Defendant pro rata in proportion to its Market Share; provided, however, that any such accelerated payments (a) shall all be adjusted upward by the greater of (i) the rate of 3% per annum or (ii) the actual total percent change in the CPI, in either instance for the period between January 1 of the year in which the acceleration of payments pursuant to this Paragraph occurs and the date on which such accelerated payments are due pursuant to this subsection, and (b) shall all immediately be adjusted in accordance with the formula for adjustments of payments set forth in Appendix A.

Nothing in this Paragraph shall be deemed under any circumstance to create any obligation on the part of any Settling Defendant to pay any amount owed or payable to the State of Minnesota by any other Settling Defendant. All obligations of the Settling Defendants pursuant to this Paragraph are intended to be and shall remain several, and not joint.

C. Public Health Foundation.

The Attorney General will propose, and the Settling Defendants have agreed not to oppose, that the Legislature appropriate to a foundation one-half the payments due in September 1998, and in January of the years 1999 through 2003, to be used for such activities as the directors of the foundation may determine will diminish the human and economic consequences of tobacco use. It is contemplated that the directors of the foundation will include public representatives, and representatives of such groups as the American Lung Association, Minnesota Chapter; the University of Minnesota School of Public Health; the Minnesota SmokeFree 2000 Coalition; the American Cancer Society, Minnesota Division; the American Heart Association, Minnesota Chapter; the Association for Non-Smokers' Rights--Minnesota; and the Mayo Clinic Nicotine Dependence Center.

D. Annual Payments.

Each of the Settling Defendants agrees that, beginning on December 31, 1998, and annually thereafter on December 31st of each year after 1998 (subject to final adjustment within 30 days), it shall severally cause to be paid to an account designated in writing by the State of Minnesota in accordance with and subject to paragraph II.E. of this Settlement Agreement, pro rata in proportion to its respective Market Share, its share of 2.55% of the following amounts (in billions):

Year	11998	11999	22000	22001	22002	22003	There-after
	1	2	3	4	5	6	
Amount	$4B	$4.5B	$5B	$6.5B	$6.5B	$8B	$8B

The payments made by Settling Defendants pursuant to this Paragraph shall be adjusted upward by the greater of 3% or the Consumer Price Index applied each year on the previous year, beginning with the annual payment due on December 31, 1999. Such payments will also be decreased or increased, as the case may be, beginning with the annual payment due on December 31, 1999, in accordance with the formula for adjustments of payments set forth in Appendix A.

E. Payment of Settlement Proceeds.

Any payment made pursuant to this Settlement Agreement shall be made to an account designated in writing by the State of Minnesota or the Court, as applicable; provided that after Final Approval, if the Court's approval is challenged by any third party, payments due to be made shall be paid into a special escrow account (the "State Escrow Account"), and held in escrow pursuant to this Section V.B. and the State Escrow Agreement.

F. Adjustments in Event of Federal Legislation.

The enactment of federal tobacco- related legislation shall not affect the payments required by this Agreement except as follows:

1. If federal tobacco-related legislation providing for the resolution or other disposition of State Attorney General actions brought against tobacco companies is enacted on or before November 30, 2000, and if such legislation provides for payment(s) by tobacco companies (whether by settlement payment, tax or any other means), all or part of which is made available to States, the State of Minnesota shall elect to

receive any funds that are (i) unrestricted as to their use, or (ii) are restricted to any form of health care or to any use related to tobacco (collectively "Federal Settlement Funds"), and Settling Defendants shall receive a dollar-for-dollar offset up to the full amount of payments required under Section II.D of this Agreement for any and all Settlement Funds received by the State of Minnesota, until all Federal Settlement Funds provided however:

a. There shall be no offset to payments required by this Agreement on account of any federal program, subsidies, payments, credits or other aid to the State which are not conditioned or tied to the settlement of a state tobacco-related suit or the relinquishment of state tobacco-related claims;

b. The State relinquishes no rights or benefits under this Agreement except for payments subject to the offset;

c. There are no federally imposed preconditions to the receipt of Federal Settlement Funds other than

(i) the settlement of any state tobacco-related lawsuit or the relinquishment of state tobacco-related claims,

(ii) actions or expenditures related to tobacco, including but not limited to, education, cessation, control or enforcement, or

(iii) actions or expenditures related to health care;

d. If Settling Defendants enter into any pre-verdict settlement agreement (subsequent to the date of this Agreement) of similar litigation brought by a non-federal governmental plaintiff which does not require such an offset, this Section is null and void;

e. If Settling Defendants enter into any pre-verdict settlement agreement (subsequent to the date of this Agreement) of similar litigation brought by a non- federal governmental plaintiff which has an offset term more favorable to the plaintiff, this Settlement Agreement shall, at the option of the Office of the Attorney General of the State of Minnesota, be revised to include a comparable term.

2. Nothing in this section is intended to or shall reduce the total amounts payable to the State under this Agreement by Settling Defendants beyond the amount of Federal Settlement Funds actually received by the State of Minnesota.

III. DISMISSAL OF CLAIMS AND RELEASES

A. State of Minnesota's Dismissal of Claims.

Upon approval of this Settlement Agreement by the Court, the Court shall enter a Final Judgment dismissing with prejudice all claims as to all Defendants.

This Agreement resolves all claims between the State and the Defendants, except for issues pending before the court pertaining to the discoverability or production of documents for which the Defendants reserve their rights of appeal.

B. State of Minnesota's Release and Discharge.

Upon Final Approval, the State of Minnesota shall release and forever discharge all Defendants and their present and former parents, subsidiaries (whether or not wholly owned) and affiliates, and their respective divisions, organizational units, officers, directors, employees, representatives, insurers, suppliers, agents, attorneys and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing) from any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly,

representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:

a. for past conduct, as to any Claims relating to the subject matter of this action which have been asserted or could be asserted now or in the future in this action or a comparable Federal action by the State; and

b. for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products;

(such past and future Claims hereinafter referred to as the "Released Claims"); provided, however, that the foregoing shall not operate as a release of any person, party or entity (whether or not a signatory to this Agreement) as to any of the obligations undertaken in this Agreement in connection with a monetary breach or default of this Agreement.

The State of Minnesota hereby covenants and agrees that it shall not hereafter sue or seek to establish civil liability against any person or entity covered by the release provided under Paragraph III.B based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agrees that this covenant and agreement shall be a complete defense to any such civil action or proceeding.

C. Settling Defendants' Release and Discharge.

Upon Final Approval, Settling Defendants shall release and forever discharge the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement) from any and all manner of civil claims, demands,

actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including costs, expenses, penalties and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory, arising out of or in any way related to, in whole or in part, the subject matter of the litigation of this lawsuit, that Settling Defendants (including any of their present and former parents, subsidiaries, divisions, affiliates, officers, directors, employees, witnesses (fact or expert), representatives, insurers, agents, attorneys and distributors and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing, and whether or not any such person participates in the settlement), whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have.

D. Limited Most-Favored Nation Provision.

In partial consideration for the monetary payments to be made by the Settling Defendants pursuant to this Settlement Agreement, the State of Minnesota agrees that if the Settling Defendants enter into any future pre-verdict settlement agreement of other similar litigation brought by a non-federal governmental plaintiff on terms more favorable to such non-federal governmental plaintiff than the terms of this Settlement Agreement (after due consideration of relevant differences in population or other appropriate factors), the terms of this Settlement Agreement shall not be revised except as follows: to the extent, if any, such other pre-verdict settlement agreement includes terms that provide

(a) for joint and several liability among the Settling Defendants with respect to monetary payments to be made pursuant to such agreement;

(b) a guarantee by the parent company of any of the Settling Defendants or other assurances of payment or creditors' remedies with respect to monetary payments to be made pursuant to such agreement; or

(c) for the implementation of non-economic tobacco-related public health measures different from those contained in this Settlement Agreement, then this Settlement Agreement shall, at the option of the Office of the Attorney General of the State of Minnesota, be revised to include terms comparable to such terms.

IV. DEFENDANTS' ASSURANCES

Settling Defendants agree not to directly or indirectly, including through any third party or affiliate:

1. Oppose the passage of those future Minnesota legislative proposals or administrative rules intended by their terms to reduce tobacco use by children listed on Schedule B. (The foregoing does not prohibit Settling Defendants from resisting enforcement of, or suing for declaratory or injunctive relief with respect to any such legislation or rule on any grounds.)

2. Facially challenge the enforceability or constitutionality of existing Minnesota laws or rules relating to tobacco control, including, but not limited to, Minnesota Statutes Section 461.17 regarding the disclosure of certain ingredients in cigarettes; Minnesota Statutes Sections 461.12, et. seq., and 609.685 regarding the sale of tobacco to minors; Minnesota Statutes Section 325F.77 regarding the distribution of samples; and Minnesota Statutes Section 144.411 et. seq. regarding clean indoor air.

3. Support in Congress or any forum, legislation, rules or policies which would preempt, override, or abrogate or diminish the State's rights or recoveries under this Agreement. Except as specifically provided in the foregoing sentence, nothing in this Agreement shall be deemed to restrain the parties from advocating terms of any national settlement or taking any other positions on issues relating to tobacco. The State and its attorneys specifically reserve the right to continue to litigate or advocate for additional

document disclosure beyond that ordered by the Ramsey County District Court, in any forum outside of Minnesota.

4. Settling Defendants' obligation to produce documents in discovery pertaining to enactment or repeal of, or opposition to, state legislation or state executive action relating to tobacco in Minnesota is extended beyond August 17, 1994, to the date of this Agreement, with Settling Defendants required to produce these documents within thirty (30) days of the date of this Agreement.

B. Disclosure of Payments Likely to Affect Public Policy.

1. Each Settling Defendant shall disclose to the Office of the Attorney General and the Office of the Governor, at the times and in the manner provided below, information about the following payments:

a. Any payment to a "lobbyist" or "principal" within the meaning of Minnesota Statutes, Section 10A.01, subdivisions 11 and 28, if Settling Defendant knows or has reason to know that the payment will be used, directly or indirectly, to influence legislative or administrative action, or the official action of state or local government in Minnesota in any way relating to Tobacco Products or their use.

b. Any payment to a third party, if the Settling Defendant knows the payment is partly in consideration for the third party attending, offering testimony at, or participating before a state or local government hearing in Minnesota in any way relating to Tobacco Products or their use; and

c. Any payment (other than a "political contribution" under Minn. Stat. § 10.01, subd. 7, or 2 USC § 431(8)(A)) to, or for the benefit of, a state or local official in Minnesota, whether made directly by a defendant or indirectly through an employee acting in the scope of his employment, affiliate, lobbyist, or other agent acting under the substantial control of a defendant.

2. Disclosures required under this section shall be filed with the Office of the Attorney General and with the Office of the Governor on the first day of January, April, July and October of each year for any and all payments made through the first day of the previous month and shall be transmitted in electronic format or such format as the attorney general may require, with the following information:

a. The name, address, telephone number and e-mail address of the recipient.

b. The amount of each payment described in Paragraph B(1).

c. The aggregate amount of all payments described in Paragraph B(1) to the recipient in the calendar year.

3. Information filed under this section is "public data" within the meaning of the Minnesota Government Data Practices Act.

C. Settling Defendants agree to discontinue all Billboards and Transit Advertisements of Tobacco Products in the State. Settling Defendants shall use their best efforts in cooperation with the State to identify all such Billboards that are located within 1000 feet of any public or private school or playground in the State, and shall provide the State with a preliminary list of the location of all Billboards and stationary Transit Advertisements within 30 days from the date hereof, such list to be finalized within an additional 15 days. Settling Defendants shall, at the earlier of the expiration of applicable contracts or four months from the date the final list is supplied to the State, remove all Billboards and Transit Advertisements for Tobacco Products from within the State, leaving the space unused or used for advertising unrelated to Tobacco Products; or at the option of the State of Minnesota, will allow the State, at its expense, to substitute for the remaining term of the contract, alternative advertising intended to discourage the use of Tobacco Products by children and their exposure to second-hand smoke. The

parties also agree to secure the expedited removal of up to 50 Billboards or stationary Transit Advertisements for Tobacco Products designated by the State within 30 days after their designation. Each Settling Defendant which has Billboard advertising in the State shall provide the Court and the Attorney General, or his designee, with the name of a contact person to whom the State may direct inquiries during the time such Billboards and Transit Advertisements are being eliminated, from whom the State may obtain periodic reports as to the progress of their elimination and who will be responsible for ensuring that appropriate action is taken to remove any Billboards that have not been timely eliminated.

D. Settling Defendants shall not make, in the connection with any motion picture made in the United States, or cause to be made any payment, direct or indirect, to any person to use, display, make reference to, or use as a prop any cigarette, cigarette package, advertisement for cigarettes, or any other item bearing the brand name, logo, symbol, motto, selling message, recognizable color or pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any brand of domestic tobacco products.

E. On and after December 31, 1998, Settling Defendants shall permanently cease marketing, licensing, distributing, selling or offering, directly or indirectly, including by catalogue or direct mail, in the State of Minnesota, any service or item (other than tobacco products or any item of which the sole function is to advertise tobacco products) which bears the brand name (alone or in conjunction with any other word), logo, symbol, motto, selling message, recognizable color or pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any brand of domestic tobacco products.

F. Settling Defendants and the Law Firm of Robins, Kaplan, Miller & Ciresi L.L.P. ("RKM&C") have reached a separate agreement for the payment of the State's costs and

attorneys fees. In consideration for said agreement, RKM&C has released the State from its obligation to pay costs and attorneys fees under the Special Attorney Appointment dated May 23, 1994.

V. MISCELLANEOUS PROVISIONS

A. Representations of Parties.

The respective parties hereto hereby represent that this Settlement Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of the parties hereto. The State represents that all of its outside counsel that have represented it in this action are, by and through their authorized representatives, signators to this Settlement Agreement.

B. Court Approval.

The Parties agree to submit this Settlement Agreement to the Court for its review and approval on Friday, May 8, 1998. If the Court declines to approve this Settlement Agreement, the Blue Cross Settlement Agreement, the form of State Escrow Agreement, and the form of Blue Cross Escrow Agreement, the matter will be immediately submitted to the jury. If the Court, as a condition of approval or otherwise, requires any change in the Agreements which any signatory is unwilling to make, the case will be immediately submitted to the jury. If before the Court approves the Agreements, any third-party seeks to intervene for the purpose of opposing the Settlement Agreement, the Blue Cross Settlement Agreement, the State Escrow Agreement, and the Blue Cross Escrow Agreement, any Party at its sole election, may withdraw from this Agreement, after first giving notice to the Court and all of the Parties before the jury is dismissed, and submit the case to the jury. If the Court approves the Settlement Agreement as submitted, the Agreement will be final and binding upon all Parties.

In the event that there is a challenge to any provision of this Settlement Agreement by anyone other than the Attorney General of the State of Minnesota as of the date of this Agreement, BCBS or Settling Defendants ("a third-party challenge@) after Final Approval, any amounts required to be paid by Settling Defendants pursuant to this Settlement Agreement shall be paid into escrow pursuant to the State Escrow Agreement. If, as a result of such a challenge, any material term of Sections II, III, IV of this Settlement Agreement is modified or rendered unenforceable, the parties shall negotiate an equivalent or comparable substitute term or other appropriate credit or adjustment. In the event that the parties are unable to agree on such a substitute term or appropriate credit or adjustment, then the parties will submit the issue to the Court for resolution, subject to any available appeal rights. In the event that any third-party challenge is made after December 31, 1998, any payments due under Paragraph II.B. shall be made to the State according to the terms of this Settlement Agreement, and only those payments due under Paragraph II.D. shall be placed into escrow as provided above.

In the event that the Court determines that there has been a failure of consideration legally sufficient to warrant termination of this Settlement Agreement, then this Settlement Agreement may be terminated by the party adversely affected. In the event of such termination, the action will be reinstated and all decisions of the trial court, and any party's appeal or other rights with respect thereto, will have the same force and effect as if this Settlement Agreement had never been entered into.

C. Obligations Several, Not Joint.

All obligations of the Settling Defendants pursuant to this Settlement Agreement are intended to be and shall remain several, and not joint.

D. Headings.

The headings of the paragraphs of this Settlement Agreement are not binding and are for reference only and do not limit, expand or otherwise affect the contents of this Settlement Agreement.

E. No Determination or Admission.

This Settlement Agreement and any proceedings taken hereunder are not intended to be and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of any liability or any wrongdoing whatsoever on the part of any party hereto or any person covered by the releases provided under paragraphs III.B. and C. hereof. The Settling Defendants specifically disclaim and deny any liability or wrongdoing whatsoever with respect to the allegations and claims asserted against them in this action and enter into this Settlement Agreement solely to avoid the further expense, inconvenience, burden and uncertainty of litigation.

F. Non-Admissibility.

The settlement negotiations resulting in this Settlement Agreement have been undertaken by the parties hereto in good faith and for settlement purposes only, and neither this Settlement Agreement nor any evidence of negotiations hereunder shall be offered or received in evidence in this action, or any other action or proceeding, for any purpose other than in an action or proceeding arising under this Settlement Agreement.

G. Amendment; Waiver.

This Settlement Agreement may be amended only by a written instrument executed by the Attorney General and the Settling Defendants. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving party. The waiver by any party of any breach of this Settlement Agreement shall not be deemed to be or construed as a waiver of any other breach,

whether prior, subsequent or contemporaneous, of this Settlement Agreement.

H. Notices.

All notices or other communications to any party to this Settlement Agreement shall be in writing (and shall include telex, telecopy or similar writing) and shall be given to the respective parties hereto at the following addresses. Any party hereto may change the name and address of the person designated to receive notice on behalf of such party by notice given as provided in this paragraph.

For the State of Minnesota:

Hubert H. Humphrey III
Attorney General
102 State Capitol
St. Paul, MN 55155
Fax: 612.297.4193

with copies to:

Michael V. Ciresi
Robins, Kaplan, Miller & Ciresi L.L.P.
2800 LaSalle Plaza
800 LaSalle Avenue
Minneapolis, MN 55402-2015
Fax: 612.339.4181

Chief Deputy Attorney General
State of Minnesota
102 State Capitol
St. Paul, MN 55155
Fax: 612.297.4193

For Philip Morris Incorporated:
Martin J. Barrington
Philip Morris Incorporated
120 Park Avenue

New York, NY 10017-5592
Fax: 212.907.5399

With a copy to:

Meyer G. Koplow
Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019
Fax: 212.403.2000

For R.J. Reynolds Tobacco Company:

Charles A. Blixt
General Counsel
R.J. Reynolds Tobacco Company
401 North Main Street
Winston-Salem, NC 27102
Fax: 910.741.2998

With a copy to:

Arthur F. Golden
Davis Polk & Wardwell
450 Lexington Avenue
New York, NY 10017
Fax: 212.450.4800

For Brown & Williamson Tobacco Corporation:

F. Anthony Burke
Brown & Williamson Tobacco Corporation
200 Brown & Williamson Tower
401 South Fourth Avenue
Louisville, KY 40202
Fax: 502.568.7297

With a copy to:

Stephen R. Patton
Kirkland & Ellis
200 East Randolph Dr.
Chicago, IL 60601
Fax: 312.861.2200

For Lorillard Tobacco Company:

Arthur J. Stevens
Lorillard Tobacco Company
714 Green Valley Road
Greensboro, NC 27408
Fax: 910.335.7707

I. Cooperation.

The parties hereto agree to use their best efforts and to cooperate with each other to cause this Settlement Agreement to become effective, to obtain all necessary approvals, consents and authorizations, if any, and to execute all documents and to take such other action as may be appropriate in connection therewith. Consistent with the foregoing, the parties hereto agree that they will not directly or indirectly assist or encourage any challenge to this Settlement Agreement by any other person. All parties hereto agree to support the integrity and enforcement of the terms of this Settlement Agreement.

J. Governing Law.

This Settlement Agreement shall be governed by the laws of the State of Minnesota, without regard to the conflicts of law rules of such state.

K. Construction.

None of the parties hereto shall be considered to be the drafter of this Settlement Agreement or any provision

hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

L. Severability.

Subject to the provisions of Paragraph V.B., the terms of this Agreement are severable. If any term of this Agreement is found to be unlawful, the remaining terms shall remain in full force and effect, and the parties agree to negotiate a substitute term of equivalent value.

M. Intended Beneficiaries.

This action was brought by the State of Minnesota, through its Attorney General, and by Blue Cross to recover certain monies and to promote the health and welfare of the people of Minnesota. No portion of this Settlement Agreement shall provide any rights to, or be enforceable by, any person or entity that is neither a party hereto nor a person encompassed by the releases provided in paragraphs III.B. and C. of this Settlement Agreement. Except as expressly provided in this Settlement Agreement, no portion of this Settlement Agreement shall bind any non-party or determine, limit or prejudice the rights of any such person or entity. None of the rights granted or obligations assumed under this Settlement Agreement by the parties hereto may be assigned or otherwise conveyed without the express prior written consent of all of the parties hereto.

N. Counterparts.

This Settlement Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered as valid signatures as of the date hereof, although the original signature pages shall thereafter be appended to this Settlement Agreement.

IN WITNESS WHEREOF, the parties hereto, through their fully authorized representatives, have agreed to this

Comprehensive Settlement Agreement and Release as of this 8th day of May, 1998.

STATE OF MINNESOTA, acting by and through Hubert H. Humphrey III, its duly elected and authorized Attorney General

By:

/s/ _____
Hubert H. Humphrey III
Attorney General

/s/ _____
Lee E. Sheehy
Chief Deputy Attorney General

/s/ _____
Eric A. Johnson
Executive Assistant to the Attorney General

/s/ _____
Thomas F. Pursell
Senior Counsel to the Attorney General

/s/ _____
D. Douglas Blanke
Director of Consumer Policy

COUNSEL TO THE STATE OF MINNESOTA
By:

/s/ _____
Michael V. Ciresi
Robins, Kaplan, Miller & Ciresi L.L.P.

PHILIP MORRIS INCORPORATED

By:

/s/_____
Meyer G. Koplow
Counsel

By:
/s/_____
Martin J. Barrington
General Counsel

R.J. REYNOLDS TOBACCO COMPANY

By:

/s/_____
D. Scott Wise
Counsel

By:

/s/_____
Charles A. Blixt
General Counsel

BROWN & WILLIAMSON TOBACCO CORPORATION

By:

/s/_____
Stephen R. Patton
Counsel

By:

/s/_____
F. Anthony Burke

Vice President and General Counsel

LORILLARD TOBACCO COMPANY

By:

/s/_____
Arthur J. Stevens
Senior Vice President & General Counsel

SCHEDULE A

AMOUNTS PAYABLE BY SETTLING DEFENDANTS ON OR BEFORE SEPTEMBER 5, 1998 PURSUANT TO PARAGRAPH II.B. OF THE SETTLEMENT AGREEMENT

Date	9/5/98
Settling Defendants	
Philip Morris Incorporated	$ 163,200,000
R.J. Reynolds Tobacco Company	$ 16,320,000
Brown & Williamson Tobacco Corporation	$ 42,960,000
Lorillard Tobacco Company	$ 17,520,000
Total Amount	$ 240,000,000

SCHEDULE B

Potential Future Legislation to Reduce Tobacco Use by Children

Legislation to expand the self-service-sale restrictions of the youth access to tobacco law and to remove the current exception for sales of cigars.

Legislation to clarify the current youth access law provision on vending machines, making clear that machines equipped with automatic locks or that use tokens are vending machines within the meaning of the law.

Legislation providing enhanced or coordinated funding for enforcement efforts under sales-to- minors provisions of the criminal code or the youth access statute and ordinances.

Legislation to encourage or support the use of technology to increase effectiveness of age-of- purchase laws, such as, without limitation, the use of programmable scanners or scanners to read drivers' licenses.

Legislation or rules restricting the wearing, carrying or display of tobacco indicia in school- related settings, including, without limitation, in school facilities, on school premises, or in connection with school-sponsored activities.

Legislation to create or stiffen non-monetary incentives for youth not to smoke, such as expansion of youth community service programs.

APPENDIX A

FORMULA FOR CALCULATING STATE OF MINNESOTA VOLUME ADJUSTMENTS

Any payment that by the terms of the Settlement Agreement is to be adjusted pursuant to this Appendix (the "Applicable Base Payment") shall be adjusted pursuant to this Appendix in the following manner:

(A) in the event the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in 1997 (the "Base Volume"), the Applicable Base Payment shall be multiplied by the ratio of the Actual Volume to the Base Volume;

(B) in the event the Actual Volume is less than the Base Volume,

(i) the Applicable Base Payment shall be multiplied by the ratio of the Actual Volume to the Base Volume, and the resulting product shall be divided by 0.98; and

(ii) if a reduction of the Applicable Base Payment results from the application of subparagraph (B)(i) of this Appendix, but the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products for the Applicable Year (the "Actual Net Operating Profit") is greater than the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products in 1997 (the "Base Net Operating Profit") (such Base Net Operating Profit being adjusted upward by the greater of the rate of 3% per annum or the actual total percent change in the Consumer Price Index, in either instance for the period between January 1, 1998 and the date on which the payment at issue is made), then the amount by which the Applicable Base Payment is reduced by the application of subparagraph (B)(i) shall be reduced (but not below zero) by 2.55% of 25% of such increase in such profits. For purposes of this Appendix, "net operating profits from domestic sales of Tobacco Products" shall mean net operating profits from domestic sales of Tobacco Products as reported to the United States Securities and Exchange Commission ("SEC") for the Applicable Year or, in the case of a Settling Defendant that does not report profits to the SEC, as reported in financial statements prepared in accordance with generally accepted accounting principles and audited by a nationally recognized accounting firm. The determination of the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products shall be derived using the same methodology as was employed in deriving such Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products in 1997. Any increase in an Applicable Base Payment pursuant to this subparagraph B(ii) shall be payable within 120 days

after the date that the payment at issue was required to be made.

(C) "Applicable Year" means (i) with respect to the payments made pursuant to paragraph II.D of the Settlement Agreement, the calendar year ending on the date on which the payment at issue is due, regardless of when such payment is made; and (ii) with respect to all other payments made pursuant to this Settlement Agreement, the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

EXHIBIT A

STATE OF MINNESOTA

COUNTY OF RAMSEY DISTRICT COURT

SECOND JUDICIAL DISTRICT

THE STATE OF MINNESOTA BY HUBERT H. HUMPHREY, III, ITS ATTORNEY GENERAL, and BLUE CROSS AND BLUE SHIELD OF MINNESOTA,

Plaintiffs,

v.

PHILIP MORRIS INCORPORATED, R.J. REYNOLDS TOBACCO COMPANY, BROWN AND WILLIAMSON TOBACCO CORPORATION, B.A.T. INDUSTRIES, P.L.C., BRITISH-AMERICAN TOBACCO COMPANY LIMITED, BAT (U.K. & EXPORT) LIMITED, LORILLARD TOBACCO COMPANY, THE AMERICAN TOBACCO COMPANY, LIGGETT GROUP, INC., THE COUNCIL FOR TOBACCO RESEARCH - U.S.A., INC., and THE TOBACCO INSTITUTE, INC.,

Defendants.

File # C1-94-8565

May 8, 1998

CONSENT JUDGMENT

WHEREAS, the State of Minnesota, by its Attorney General, Hubert H. Humphrey III, and Blue Cross and Blue Shield of Minnesota filed their Complaint herein on August 17, 1994, and their Second Amended Complaint on January 6, 1998;

WHEREAS, Defendants have contested the claims in the Plaintiffs' Complaint and Second Amended Complaint;

WHEREAS, the parties recognize that Congress is considering national tobacco legislation and have agreed to settle this case on a basis which acknowledges possible federal legislation, but which guarantees to the people of Minnesota the relief granted herein;

WHEREAS, Settling Defendants, in the Settlement Agreement and Stipulation for Entry of Consent Judgment, have waived as specified therein their right to challenge the terms of this Consent Judgment as being superseded or preempted by future Congressional enactments; and

WHEREAS, the Attorney General believes the entry of this Consent Judgment is appropriate and in the public interest;

NOW THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

I. JURISDICTION AND VENUE

The Court has jurisdiction over the subject matter of this action and over the Settling Defendants under Minn. Stat. §§ 8.31, 325D.15, 325D.45, 325D.58, 325F.70 and 484.01 (1994). Venue is proper in Ramsey County pursuant to Minn. Stat. §§ 325D.65 and 542.09 (1994) in that Settling Defendants do business in Ramsey County.

II. DEFINITIONS

The definitions set forth in the Settlement Agreement and Stipulation for Entry of Consent Judgment ("Settlement Agreement") are incorporated by reference herein.

III. APPLICABILITY

This Consent Judgment applies only to Settling Defendants in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies and penalties in Sections XD. and E. herein for a violation of this Consent Judgment shall apply only to Settling Defendants, and shall not be imposed or assessed against any employee, officer or director of Settling Defendants or other person or entity as a consequence of such a violation, and there shall be no jurisdiction under this Consent Judgment to do so.

IV. EFFECT ON THIRD PARTIES

This Consent Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof, or create for any person other than the parties hereto a right to enforce the terms hereof.

V. INJUNCTIVE RELIEF

Settling Defendants are permanently enjoined from:

A. On and after December 31, 1998, marketing, licensing, distributing, selling or offering, directly or indirectly, including by catalogue or direct mail, in the State of Minnesota, any service or item (other than tobacco products or any item the sole function of which is to advertise tobacco products) which bears the brand name (alone or in conjunction with any other word), logo, symbol, motto, selling message, recognizable color or pattern of colors, or any other indicia or product identification identical or similar to, or identifiable with, those used for any domestic brand of tobacco products.

B. Making any material misrepresentation of fact regarding the health consequence of using any tobacco product, including any tobacco additives, filters, paper or

other ingredients. Nothing in this paragraph shall limit the exercise of any First Amendment right or any defense or position which persons bound by this Consent Judgment may assert in any judicial, legislative, or regulatory forum.

C. Entering into any contract, combination or conspiracy between or among themselves, which has the purpose or effect of: (1) limiting competition in the production or distribution of information about the health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into, marketing, or development of new products.

D. Taking any action, directly or indirectly, to target children in Minnesota in the advertising, promotion, or marketing of cigarettes, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of underage smoking in Minnesota.

VI. DISSOLUTION OF DEFENDANT COUNCIL FOR TOBACCO RESEARCH

Settling Defendants represent that they have the authority to effectuate the following and will do so within 90 days of this Agreement: The Council for Tobacco Research-U.S.A. Inc. shall cease all operations except as necessary to comply with existing grants or contracts and to continue its defense of other lawsuits and will be disbanded and dissolved within a reasonable time period thereafter. To the extent not required elsewhere in this Consent Judgment, the Council for Tobacco Research shall forward all smoking and health research in its possession or control to the Food and Drug Administration subject to appropriate confidentiality protection required by contracts between the Council for Tobacco Research and any third party. Defendants shall preserve all other records of the Council for Tobacco Research which relate in any way to issues raised in this or any other Attorney General lawsuit. Defendants may not

reconstitute the Council for Tobacco Research or its function in any form.

VII. PUBLIC ACCESS TO DOCUMENTS AND COURT FILES

The Court's previous Protective Orders are hereby dissolved with respect to all documents, including the 4A and 4B indices and the privilege logs, which have been produced to the Plaintiffs and for which Defendants have made no claim of privilege or Category II trade secret protection. Such documents shall be made available to the public at the Depository, in the manner provided as follows:

1. The public shall be given access to all non-privileged documents contained in the Minnesota Depository, including all documents set forth in Paragraph VII.A. above.

2. Plaintiffs and Settling Defendants shall meet with representatives of the current Minnesota Depository administrators, Smart Legal Assistance and Merrill Corporation, and/or other appropriate persons, to discuss staffing issues and the procedures that should be implemented to continue the operation of the Minnesota Depository, thereby to ensure broad and orderly access to these documents.

3. Category II documents shall be returned to the Defendants as soon as practical, provided that Defendants, upon receiving appropriate assurances of trade secret protection from the Food and Drug Administration, shall forward a copy of the Category II documents bearing the Bates numbers from this action to said agency. Plaintiffs shall retain the Bates stamp numbers of all Category II documents produced in this case.

B. The documents produced in this case are not "government data" under the Minnesota Government Data Practices Act.

C. For documents upon which a privilege was claimed and found not to exist, including any briefs, memoranda and other pleadings filed by the parties which include reference to such documents, Plaintiffs may seek court approval to make such documents available to the public, provided that any such request be made to the Court within 45 days of the date of entry of this Consent Judgment.

D. Defendant British-American Tobacco Company Limited shall maintain and operate the Guildford Depository for a period of ten years. Defendant British-American Tobacco Company Limited shall have the option of maintaining such depository at its current location or at an appropriate alternative location. All documents, except those identified in Paragraph VII.A.3 above, which were selected by plaintiffs from the Guildford Depository in response to the Plaintiffs' discovery requests shall be moved to and retained at the Minnesota Depository.

E. The Minnesota Depository shall be maintained and operated at Settling Defendants' sole expense, in the manner set forth above for ten years after the date hereof, or such longer period as may be provided in federal legislation for a national document depository. At the end of such period, or sooner, at the State's discretion, the documents shall be transferred to the State Archives or other appropriate state body, where they shall remain available for historical and research purposes. The parties and the Depository staff shall cooperate with the State Archivist or such other state officials as may be involved in transferring the documents to the custody of the State.

F. Settling Defendants shall provide to the State for the Depository a copy of all existing CD-ROMs of documents produced in this action that do not contain any privileged or work-product documents or information, to be placed in the Depository.

G. Defendants shall produce to the Depository all documents produced by such defendants in other United

States smoking and health litigation but not previously produced in Minnesota, within 30 days of their production such the other litigation, provided Defendants do not claim privilege with respect to such documents, and provided such documents are not subject to any protective order.

VIII. EQUITABLE RELIEF: NATIONAL RESEARCH; DEPOSIT OF FUNDS.

A. In furtherance of the equitable relief sought by the State, pursuant to the Court's equitable powers to shape appropriate injunctive relief, in light of the public health interests demonstrated by the evidence in this case, and pursuant to the agreement of the parties:

1. Consistent with the Prayer for Relief in the State's Complaint and Amended Complaints that the Defendants fund cessation programs in the State of Minnesota, the amount due in December, 1998 ($102 million), pursuant to the Settlement Agreement, Section II.D, shall be deposited into a separate cessation account and used to offer smoking cessation opportunities to Minnesota smokers, and shall be administered as ordered by the Court.

2. In addition to other money paid under this Consent Judgment and the Settlement Agreement and Stipulation for Entry of Consent Judgment, each Settling Defendant shall pay pro rata in proportion to its Market Share, on or before June 1, 1998, and no later than June 1 of each succeeding year through and including June 1, 2007, its share of $10 million into a national research account, to be administered as ordered by the Court. The parties envision that approximately 70% of the $100 million total will be used for research grants relating to the elimination of tobacco use by children, and 30% for program implementation, evaluation and other tobacco control purposes; provided, however, the administrator of the national research account may, in its discretion, change the allocation.

3. The State shall submit a plan for the administration and authorized uses of the funds payable under this section within 45 days of the date of entry of this Consent Judgment.

4. Monies payable under this section and Section V.B. of the Settlement Agreement shall be deposited in interest bearing accounts at a bank to be designated by the Commissioner of Finance. Settling Defendants' payment of the amounts set forth above are Settling Defendants' sole obligation under this section.

B. Except as specified in this section and Section V.B of the Settlement Agreement, all monies payable under Sections II.B. and D. of the Settlement Agreement between the parties shall be deposited into the general fund of the State of Minnesota.

IX. FINAL DISPOSITION

This Consent Judgment resolves all claims set forth in the State's Second Amended Complaint against Defendants, which are hereby dismissed with prejudice, and shall constitute the final disposition of this action.

X. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained for the purpose of enforcement and enabling the continuing proceedings contemplated herein. Any party to this Consent Judgment may apply to this Court at any time for such further orders and directions as may be necessary or appropriate for the construction and enforcement of this Consent Judgment.

B. This Consent Judgment is not intended to be and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of personal jurisdiction or any liability or any wrongdoing whatsoever on the part of any Defendant. The Defendants specifically disclaim any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against them in this action and Settling Defendants have stipulated to entry of this Consent

Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as provided in Section III.D. of the Settlement Agreement and Stipulation for Entry of Consent Judgment, this Consent Judgment shall not be modified unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions; provided, however, that the provisions of Section III of this Consent Judgment shall in no event be subject to modification. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that Settling Defendants will comply with this Consent Judgment as originally entered, even if Settling Defendants' obligations hereunder are greater than those imposed under current or future law. Therefore, a change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Settling Defendants shall not support modification of this Consent Judgment.

D. In enforcing this Consent Judgment the Attorney General shall have the discovery powers of Minn. Stat. § 8.31 (1996), as amended. Any Settling Defendant which violates this Consent Judgment shall be subject to contempt and to the remedies provided in Minn. Stat. § 8.31 (1996), as amended. In addition, in any proceeding which results in a finding that a Settling Defendant violated this Consent Judgment, the responsible Settling Defendant or Settling Defendants shall pay the State's costs and attorneys' fees incurred in such proceeding.

E. The remedies in this Consent Judgment are cumulative and in addition to any other remedies the State may have at law or equity. Nothing herein shall be construed to prevent the State from bringing any action for conduct not released hereunder, even though that conduct may also violate this Consent Judgment.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: May 8, 1998

/s/ _____

KENNETH J. FITZPATRICK

Judge of District Court

JUDGMENT

Pursuant to the foregoing Consent Judgment, judgment is hereby entered accordingly.

Dated: May 19, 1998

/s/ _____

Court Administrator

No. 06-633

12/7/06

In The

Supreme Court of the United States

PHILIP MORRIS USA, INC., ET AL.,

Petitioners,

v.

STATE OF MINNESOTA,

Respondent.

On Petition For A Writ Of Certiorari To The Minnesota Supreme Court

BRIEF FOR THE RESPONDENT IN OPPOSITION

MIKE HATCH
Minnesota Attorney General
BRADFORD S. DELAPENA
Assistant Attorney General
RITA COYLE DEMEULES
(Counsel of Record)
Assistant Attorney General
445 Minnesota Street, Suite 900
St. Paul, MN 55101-2127
(651) 296-0692

Attorneys for Respondent

QUESTION PRESENTED

In 1994, the State of Minnesota brought state common law and statutory claims against Petitioners in Minnesota state court. On May 8, 1998, the State and Petitioners entered into a Settlement Agreement, which contained mutual release-of-claims provisions. Seven years later, the Minnesota Legislature enacted legislation that imposed a fee on all cigarettes. Petitioners invoked the continuing jurisdiction of the state court over the Settlement Agreement and brought a motion to enforce that Agreement. Petitioners argued that the Legislature's fee was a "released claim" under the Settlement Agreement and consequently could not be enforced against them or their products without breaching the Agreement and/or violating the Contract Clauses of the United States and Minnesota Constitutions. The State asserted that the fee was a valid legislative exaction not prohibited by the Settlement Agreement. Thus, the threshold issue before the state court was interpretation of the Settlement Agreement. The Minnesota Supreme Court interpreted the contract under state law, including the state-law doctrine of unmistakability, and held that it did not surrender the State's sovereign legislative powers in language "too clear to admit of doubt." Based on that construction, the court summarily rejected Petitioners' state Contract Clause argument, and did not mention the analogous federal clause. Assuming, however, that the state court resolved Petitioners' federal Contract Clause challenge, the question presented is whether the Minnesota Supreme Court properly applied the doctrine of unmistakability in harmony with the protections afforded by the federal Contract Clause.

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OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent State of Minnesota respectfully requests that the Court deny the Petition for Writ of Certiorari seeking review of the Minnesota Supreme Court's opinion and judgment in this case. The Minnesota Supreme Court's opinion is published at 713 N.W.2d 350 (Minn. 2006), and is reproduced in Petitioners' Appendix ("Pet. App.") at Pet. App. 1a-27a. The trial court's Order on Petitioners' Motion for Enforcement of the Settlement Agreement, which is unpublished, is reproduced at Pet. App. 28a-38a.

STATEMENT OF JURISDICTION

Petitioners incorrectly invoke this Court's jurisdiction under 28 U.S.C. § 1257(a). The Minnesota Supreme Court neither addressed nor resolved any federal question. Instead, the state court applied state law to summarily reject Petitioners' state contract clause challenge. Thus, an adequate and independent state ground supports the court's decision and precludes jurisdiction in this Court. *See infra* at 6-13.

STATEMENT OF THE CASE

The State, through its attorney general, brought suit against Petitioners and others in 1994, asserting state common law and statutory claims in connection with Petitioners' marketing and distribution of cigarettes. Pet. App. 3a, 50a, 97a. In May 1998, after a lengthy trial but before the jury returned a verdict, the State and Petitioners entered

into a Settlement Agreement to resolve the State's legal claims. Pet. App. 96a. Among other benefits, that Agreement resolved "all claims" between the State and Petitioners. Pet. App. 107a. The term "claims" was defined as follows:

> [T]he State of Minnesota shall release and forever discharge [Petitioners] . . . from any and all manner of *civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees*, known or unknown, suspected or unsuspected, accrued or unaccrued, *whether legal, equitable or statutory* ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:
>
> > for past conduct, as to any Claims relating to the subject matter of this action . . . ; and
> >
> > for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for

> health care costs allegedly associated with use of or exposure to Tobacco Products.

Pet. App. 107a-08a (emphasis added).

Seven years later, on July 14, 2005, Minnesota's governor signed into law a Tobacco Health Impact Fee effective August 1, 2005. *See* Act of July 14, 2005, ch. 4, art. 4, §§ 1-6, 2005 Minn. Laws (1st Sp. Sess.) 2541-44 (codified at Minn. Stat. § 256.9658) ("the HIF Act"). Pet. App. 43a-44a. The HIF Act imposes a 75-cent per-pack fee on cigarettes. Pet. App. 43a. Minnesota law requires this fee to be passed on to the consumer. Pet. App. 9a. In enacting the HIF Act, the legislature stated that the purpose of the fee was to "recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths." Pet. App. 43a.

On August 26, 2005, Petitioners moved to enforce the Settlement Agreement in the Minnesota state district court that retained jurisdiction over that Agreement. Pet. App. 89a, 98a. Petitioners argued that, because the Settlement Agreement released them (and their distributors) from any and all "claims" to recover state healthcare costs attributable to tobacco use, enforcement of the HIF breached the Agreement and violated the Contract Clauses of the United States and Minnesota Constitutions. Pet. App. 91a-92a. The State opposed the Motion arguing that, properly construed, the Agreement does not bar collection of the HIF. Respondent's Appendix ("Resp. App.") 46a. The state district court found the HIF Act barred by the Settlement Agreement and granted Petitioners' Motion. Pet. App. 29a-30a.

The State petitioned for review in the Minnesota Supreme Court, arguing that the Settlement Agreement

released only adjudicatory claims and did not prohibit future legislation. Resp. App. 49a-50a. Any other construction, the state argued, would limit the state's sovereign powers and, under state law, such a waiver would have to be set forth in terms "too clear to admit of doubt." Resp. App. 49a. Once the Agreement was properly construed under state law, the State argued, there was no violation of the Settlement Agreement and no impairment under the Contract Clause. Resp. App. 11a-12a, 20a-22a, 50a-51a.

In an Order dated May 16, 2006, the Minnesota Supreme Court first found that Petitioners do not bear the economic burden of the HIF Act, even though one of the express purposes of the Act is recover healthcare costs of the State. Pet. App. 8a-9a. Next, the court recognized that construing the release language with the breadth Petitioners urged would work a surrender of sovereign power. Thus, the court concluded that the state law doctrine of unmistakability announced in *State v. Great Northern Railway Co.*, 119 N.W. 202 (Minn. 1908), *aff'd, Great Northern Railway Co. v. State*, 216 U.S. 206 (1910) applied. Pet. App. 14a, 21a. Concluding that the Agreement did not surrender the State's sovereign power in terms "too clear to admit of doubt," the Minnesota court summarily rejected Petitioners' *state* Contract Clause challenge. Pet. App. 24a-25a. No other constitutional challenge, state or federal, was considered or resolved in the Minnesota Supreme Court's decision.

REASONS FOR DENYING THE PETITION

The Petition does not present a proper occasion for this Court to assert jurisdiction. The Minnesota Supreme Court applied state law doctrines of contract construction to determine that the Agreement did not preclude the state from imposing the fee on Petitioners' products. The court rejected Petitioners' broad reading of the Agreement and then summarily rejected their state constitutional challenge. The court neither addressed nor resolved a federal question. Thus, the jurisdiction that Petitioners invoke under 28 U.S.C. § 1257(a) does not exist.

Second, the Minnesota Supreme Court correctly recognized that the unmistakability doctrine – state and federal – protects state regulatory powers from undue restriction by the Contract Clauses. Thus, even if the court had applied the federal doctrine, it would have done so correctly and in a manner that preserves the protections of the federal Contract Clause.

Third, Petitioners inaccurately portray the lower courts' application of the principles drawn from the plurality opinions in *United States v. Winstar*. As have two federal circuit courts, the Minnesota Supreme Court correctly recognized that on factual situations such as those presented here, the doctrine is properly applied to proprietary contracts. Any uncertainty that Petitioners perceive concerning application of the unmistakability doctrine stems from issues that are not presented by this case; thus, any clarification urged by Petitioners would be purely advisory as it would not apply to the facts presented.

I. ADEQUATE AND INDEPENDENT STATE GROUNDS SUPPORT THE MINNESOTA SUPREME COURT'S DECISION. THE PETITION THEREFORE FAILS TO INVOKE THIS COURT'S JURISDICTION.

The Minnesota Supreme Court construed a settlement agreement governed by *Minnesota state law* that was executed to resolve *Minnesota state law claims* brought in *Minnesota state court*. *See* Pet. App. 96a-97a, 119a. Once it did so, the court summarily rejected Petitioners' argument that the HIF Act violated "the Contract Clause of the Minnesota Constitution, Minn. Const. art. I, § 11." Pet. App. 24a.[1] In rendering its decision, the Minnesota Supreme Court applied state law rules of contract construction including the rule of construction from *State v. Great Northern Railway*, 119 N.W. 202 (Minn. 1908), the federal analogue of which was explicated by this Court in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), to reject Petitioners' interpretation of the Agreement. *See* Pet. App. 21a (noting that language of Settlement Agreement did not meet the state law rule of *Great Northern Railway*). In short, the Minnesota Supreme Court addressed and resolved a state law question by applying state law, even though it also discussed an analogous federal decision. Because the Minnesota Supreme Court did not address or decide any federal question, this Court does not have jurisdiction.

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[1] Petitioners also challenged the HIF Act under Article I, § 10, clause 1 of the United States Constitution. *See* Pet. App. 92a. As explained *infra*, however, the Minnesota Supreme Court specifically and plainly addressed only the Minnesota Constitution's prohibition against contract impairment. Petitioners raised no other federal challenges.

Section 1257 constrains this Court's review of the final judgment of a state court. *See* 28 U.S.C. § 1257(a). It is axiomatic that this Court will not review a state court decision unless a federal question has been raised *and decided* by that court. *See Coleman v. Thompson*, 501 U.S. 722, 729 (1991) ("This Court will not review a question of federal law decided by a state court if the decision of that court rests on a state law ground that is independent of the federal question and adequate to support the judgment."); *Herb v. Pitcairn,* 324 U.S. 117, 125 (1945) ("This Court from the time of its foundation has adhered to the principle that it will not review judgments of state courts that rest on adequate and independent state grounds."). The reason for this rule is "so obvious that it has rarely been thought to warrant statement." *Herb*, 324 U.S. at 125. "Because this Court has no power to review a state law determination that is sufficient to support the judgment, resolution of any independent federal ground for the decision could not affect the judgment and would therefore be advisory." *Coleman*, 501 U.S. at 729; *see also Herb*, 324 U.S. at 126 (noting that this Court's jurisdiction is limited to correcting state court judgments that "incorrectly adjudge federal rights").

The longstanding restraint on this Court's jurisdiction over state court judgments bars granting this Petition. The Settlement Agreement is governed by, and was construed under, Minnesota law. *See* Pet. App. 119a. The "interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 60, n.4 (1995) (*quoting Volt Info. Servs., Inc. v. Bd. of Tr. of Leland Stanford Junior University*, 489 U.S. 468, 474 (1989)); *see also Memphis Natural Gas Co. v. Beeler*,

315 U.S. 649, 654 (1942) (noting that "meaning and effect of contract" are "local questions" which this Court does not review).[2] Here, the Minnesota Supreme Court applied state law, first to construe the HIF Act, *see* Pet. App. 8a-9a; and then to construe the Settlement Agreement language. *See* Pet. App. 21a (noting commonality of language used in release provision); *id.* at 22a-23a (construing language in light of Minnesota's cigarette pricing scheme).[3]

The construction the Minnesota Supreme Court reached obviated the need to reach Petitioners' state or federal Contract Clause arguments. *See Fox Film Corp. v. Muller*, 296 U.S. 207 (1935). In *Fox Film*, the Minnesota Supreme Court construed contracts that admittedly violated federal antitrust laws to determine whether the illegal clause could be severed from those contracts. *Id.* at 208-09. After the court rejected severance, thus invalidating the contracts, the plaintiff petitioned this Court, asserting that the federal antitrust question was decided as part of the contract construction. *Id.* at 209. This Court disagreed:

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[2] While the decision in *Memphis Natural Gas* suggested that a state court's decision on state law could be reviewed if that law was used to evade federal law, 315 U.S. at 654, Petitioners do not allege, nor could they, that the Minnesota Supreme Court addressed the state constitutional claim only as a means to evade the federal constitutional claim.

[3] Petitioners thus have no basis for their blithe assertion that, "If the unmistakability doctrine had not been applied below, the [HIF Act] indisputably would have been found to impair the settlement agreement." Pet. at 15. In addition to plain meaning construction, the State and amicus provided the Court with several alternative state law grounds on which Petitioners' arguments to avoid the HIF could be rejected. *See* Resp. App. 24a-25a, 68a-85a, 106a-115a.

> The construction put upon the contracts did not constitute a preliminary step which simply had the effect of bringing forward for determination the federal question, but was a decision which automatically took the federal question out of the case if otherwise it would be there. The nonfederal question in respect of the construction of the contracts and the federal question in respect of their validity under the Anti-Trust Act were clearly independent of one another. The case, in effect, was disposed of before the federal question said to be involved was reached. A decision of that question then became unnecessary; and whether it was decided or not, our want of jurisdiction is clear.

Id. at 211 (citations omitted).

Here, the Minnesota court's "nonfederal" contract construction established that the terms of the Agreement were not implicated by the HIF Act. This construction allowed the court to summarily reject Petitioners' state constitutional challenge without analysis. *See* Pet. App. 24a-25a ("Because we construe the settlement agreement not to waive the legislature's authority to enact future legislative revenue measures to recover health care costs, the enactment of the [HIF] did not impair that agreement and therefore did not violate the [Minnesota] Contract Clause."). The court's construction likewise obviated any need to address Petitioners' federal Contract Clause argument. Consequently, the federal constitutional challenge asserted in the trial court – which was neither addressed nor resolved by the Minnesota Supreme Court – was "automatically . . . out of the case if otherwise it would

be there" based on the nonfederal contract construction. *Fox Film Corp.*, 296 U.S. at 211.[4]

For this reason, Petitioners' assertion that the Minnesota Supreme Court reviewed a federal question simply because Petitioners asserted it is wrong. *See* Pet. at 8, n.2 citing *Delaware v. Prouse*, 440 U.S. 648 (1979). In *Delaware*, the state court began with the federal constitutional claim, "analyzed the various decisions interpreting the Federal constitution, concluded that the Fourth Amendment [was infringed], and summarily held that the State Constitution was therefore also infringed." *Id.* at 652-53. The lower court's decision thus "depended upon [its] view of the reach of the Fourth and Fourteenth Amendments." *Id.* at 653.

Review in this Court was therefore proper. Accepting jurisdiction in this case merely because Petitioners asserted a federal claim, in contrast, would disregard the limitations of Section 1257 and undermine the adequate and independent state grounds rule. Indeed, the Court has already rejected this unrestricted view of federal question jurisdiction. *See Enter. Irrigation Dist. v. Farmers' Mut. Canal Co.*, 243 U.S. 157, 165 (1917) (dismissing for "want of jurisdiction" even though federal constitutional challenges were part of case, where state law issues were addressed separately and this Court was "not at liberty to inquire whether the ruling is right or wrong").

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[4] The state and federal contracts clauses are interpreted similarly. *See* Pet. at 8, n.2. Thus, the Minnesota court's decision would not change *even if* the federal claim was treated similarly, i.e., summarily rejected. *See Coleman*, 501 U.S. at 729 (noting that independent federal ground "that could not affect the judgment" does not support jurisdiction).

Likewise, this Court has no need to determine the contract terms to which the federal Contract Clause might apply. This Court assumes jurisdiction to decide the existence and terms of a contract only when a state court addresses and resolves a federal Contract Clause claim. *See Gen. Motors Corp. v. Romein*, 503 U.S. 181, 187 (1992) (noting that existence of contract is a federal question for purposes of contract impairment claim asserted under federal constitution); *Mun. Investors Ass'n v. City of Birmingham*, 316 U.S. 153, 157 (1942) (noting this Court's obligation "to determine for itself the basic assumptions upon which interpretations of the Federal Constitution rest"); *State of Indiana ex rel. Anderson v. Brand*, 303 U.S. 95, 98-99 (1938) (lower court admitted that constitutional claim was based on federal constitution, thus supporting Court's jurisdiction to determine the terms of the contract). Since the Minnesota court summarily rejected only a state constitutional challenge, an adequate and independent state ground precludes this Court's jurisdiction.

The Minnesota Supreme Court's state law resolution is also adequate and independent notwithstanding that court's discussion of *United States v. Winstar Corp.*, 518 U.S. 839 (1996). The Minnesota Supreme Court relied on *Winstar* "as it would on the precedents of all other jurisdictions[.]" *Michigan v. Long*, 463 U.S. 1032, 1040 (1983). It *decided* the contract construction issue, however, exclusively by reference to state doctrine: "We cannot say that the language of the settlement agreement effects such a waiver of the state's sovereign powers in language 'too clear to admit of doubt.'" Pet. App. 21a (*quoting Great N.*

Ry. Co., 119 N.W. at 205).[5] Thus, even if this Court were to conclude, as Petitioners urge, that *Winstar's* plurality opinions should be clarified, such an effort would be purely advisory as it would have no effect below. The Minnesota Supreme Court could reach the same decision by once again construing the contract under the state law unmistakability doctrine from *Great Northern Railway*.

Finally, there is an additional reason to decline review. The State argued below that because the Agreement resolved only common law and statutory claims the State had asserted in its proprietary capacity, the Agreement's boilerplate release-of-claims provision was simply a conventional promise not to sue, and could not reasonably be construed as a surrender of sovereign power. *See* Resp. App. 52a-58a. The state court adopted this reasoning in part. *See* Pet. App. 19a ("we cannot help but note that the phrase 'liabilities of any nature whatsoever' (or similar language) is commonly used in general release forms in disputes having nothing to do with any sovereign power."). Although this construction of the Agreement would have been sufficient to resolve the case, the state court applied the Minnesota unmistakability doctrine in an abundance of caution, determining that *even if* the release provision were somehow ambiguous, it could not surrender sovereign power. *See* Pet. App. 21a. The concurring Justice, however, found no need to apply the doctrine:

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[5] The absence of a statement disclaiming any federal basis for the state court's decision, *see Long*, 463 U.S. at 1040, does not require this Court to assume jurisdiction. The federal constitution was not mentioned in the decision below. In *Long*, in contrast, the state court "relied exclusively on its understanding" of federal law and "not a single state case was cited." *Id.* at 1043.

> I read the settlement agreement and its release of "claims" to unambiguously cover no more than the claims the state brought or could have brought against [Petitioners] in the 1994 tobacco litigation or could bring in future litigation. Imposition of the Health Impact Fee does not create such a "claim." Therefore, I would hold that under the unambiguous language of the settlement agreement, imposition of the Health Impact Fee did not violate the settlement agreement.

Pet. App. 27a (footnote omitted) (Page, J., specially concurring). If this Court agreed with this reasoning, it would have no occasion to apply the unmistakability doctrine, federal or otherwise, and thus could not clarify federal law. *Cf. Winstar*, 518 U.S. at 880, n.24 (1996) (noting that doctrine may not be applicable where "normal rules of construction" may dispose of proposed construction).

Because the Petition presents no federal question, it should be dismissed.

II. THE MINNESOTA SUPREME COURT'S DECISION DOES NOT CONFLICT WITH THIS COURT'S CONTRACT CLAUSE JURISPRUDENCE.

Petitioners claim that by applying the unmistakability doctrine, the Minnesota Supreme Court deviated from this Court's Contract Clause jurisprudence. This is plainly incorrect. The unmistakability doctrine developed as a part of this Court's Contract Clause jurisprudence, and in no way vitiates the protection federal law affords contracts. Although the state court applied Minnesota's version of the doctrine, that application is fully consistent with this Court's application of the federal doctrine.

A. The Federal Unmistakability Doctrine Is Part Of This Court's Contract Clause Jurisprudence.

The Contract Clause provides that, "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. Const., art. I, § 10. The Clause limits state power "when its exercise effects substantial *modifications* of private contracts." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978) (emphasis added). As relevant here, a state may not enter a contract, then use its legislative power to substantially modify contractual obligations.

The federal unmistakability doctrine developed as a part of this Court's Contract Clause jurisprudence "to protect state regulatory powers." *United States v. Winstar Corp.*, 518 U.S. 839, 874 (1996) (plurality opinion). "Although [the Contract] Clause made it possible for state legislatures to bind their successors by entering into contracts, it soon became apparent that such contracts could become a threat to the sovereign responsibilities of state governments." *Id.* Thus, the unmistakability doctrine is a canon of construction that rejects "implied governmental obligations in public contracts," *id.* at 874, thereby limiting the extent to which the Contract Clause curtails state powers.

> Under this rule that all public grants are strictly construed, we have insisted that nothing can be taken against the State by presumption or inference, and that neither the right of taxation, nor any other power of sovereignty, will be held . . . to have been surrendered, unless such surrender has been expressed in terms too plain to be mistaken.

Id. at 874-75 (ellipsis in original) (internal quotation marks and citations omitted). Because the unmistakability doctrine construes contracts to protect state regulatory powers, its applicability "turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power. . . . " *Id.* at 879.

B. The Minnesota Supreme Court's Decision Is Correct And Is In Harmony With This Court's Contract Clause Jurisprudence.

As already noted, the Minnesota Supreme Court applied the unmistakability doctrine as a matter of state law rather than federal law. *See supra* at 6-12. But even if the state court had applied the federal doctrine, its application would be correct and in perfect harmony with this Court's Contract Clause jurisprudence.

From the start, Petitioners have alleged that the provision of the Settlement Agreement by which the State released all of its past, present and future "claims" (the "State's Release") prevents the Minnesota Legislature from imposing on Petitioners, and the Revenue Department from enforcing against them, the 75-cent per-pack HIF on Petitioners' products.[6] Attempting to avoid application of

[6] *See, e.g.*, Pet. App. 10a (Petitioners "argue that the imposition of the fee violates the settlement agreement"); *id.* at 12a (Petitioners assert the HIF "cannot be enforced against them, or, apparently, their products"); *id.* at 18a (Petitioners "argue that the consequence of the promise made by the state is that the exercise of sovereign power by the legislature is unenforceable as to them and their products"); *id.* ("the very relief [Petitioners] seek requires the state either to exempt [Petitioners] from the exercise of the state's sovereign powers to tax and to regulate, or to surrender those powers with respect to the cigarette industry altogether").

the unmistakability doctrine, Petitioners asserted – without authority – that the doctrine does not apply to contracts a state enters in its proprietary capacity, such as the Settlement Agreement. The state court rejected this argument. *See* Pet. App. 16a, n.5. In line with this Court's cases, the state court properly held that application of the doctrine instead turns on the nature of the government's obligations "and the consequences of enforcing them."[7] *Id.* Accordingly, the state court concluded that "to construe the settlement agreement as [Petitioners] urge, that is, to waive the legislature's authority to enact revenue measures to recover tobacco-related health care costs, would be a surrender of the legislature's sovereign power." Pet. App. 14a. The court correctly determined that Petitioners' allegations implicated the doctrine. *See* Pet. App. 14a, 20a.

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[7] Petitioners' assertion that the unmistakability doctrine does not apply to contracts a state enters in its proprietary capacity is plainly incorrect, and is unsupported by any of the authorities Petitioners cite. *See* Pet. at 11-15 & nn.4-5. First, this Court has applied the doctrine to proprietary contracts. *See infra* at 19-21 (discussing *Merrion v. Jicarilla Apache Tribe*, 453 U.S. 130 (1982)). Second, the two cases Petitioners discuss at length, *Murray v. Charleston*, 96 U.S. 432 (1877) and *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977) show only that some Contract Clause cases involving proprietary contracts do not require application of the unmistakability doctrine (because the plaintiff does not allege that the disputed contract surrenders sovereign power, but only that legislative power was used to modify a contractual obligation). *See* 96 U.S. at 444-45; 431 U.S. at 23-24. These cases neither hold nor suggest that the doctrine does not apply to proprietary contracts. Finally, Petitioners' assertion is not supported by cases stating the general rule that government contracts are interpreted and construed like private contracts. *See* Pet. at 14. The unmistakability doctrine is an exception to the general rule, and applies whenever enforcement of a government obligation would impair a state's sovereign power. *See Winstar*, 518 U.S. at 879; *id.* at 920-21 (Scalia, J., concurring in the judgment).

The state court correctly applied the doctrine. The court recognized that it must "examine the language of the [State's Release] to determine not just whether it supports a waiver of the legislature's power to enact future revenue measures expressly intended to address the costs of tobacco-related health care, but whether it does so in unmistakable terms." Pet. App. 20a. The court stated that in doing so, it was

> guided by the principles of construction stated in *Great Northern Railway* and *Winstar*. We are not to draw inferences from indefinite language or make presumptions from uncertain language. *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205; *Winstar*, 518 U.S. at 874, 116 S.Ct. 2432. Rather, the settlement agreement is to be strictly construed, and any waiver of sovereign power must be "in language and terms too clear to admit of doubt." *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205; *see also Winstar*, 518 U.S. at 874, 116 S.Ct. 2432.

Pet. App. 20a. These principles fully conform to *Winstar*.[8]

The state court applied the doctrine's rule of strict construction to the State's Release and concluded that it did not surrender the state's sovereign police or taxing powers. *See* Pet. App. 21a. The court set forth its reasoning as follows:

> Application of the unmistakability doctrine compels the conclusion that the settlement agreement

[8] Moreover, the structure of the state court's citations confirms that the court was applying the state version of the unmistakability doctrine set forth in *Great Northern Railway*, although it also drew support by analogy from the federal version of the doctrine elaborated in *Winstar*.

> cannot be construed to waive the legislature's sovereign authority under the tax and police powers to enact revenue measures, even if earmarked for payment of tobacco-related health care costs. We cannot say that the language of the settlement agreement effects such a waiver of the state's sovereign powers in language "too clear to admit of doubt." *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205. Although the phrase "liabilities of any nature whatsoever" is broad, it is insufficiently specific to meet the requirements of the unmistakability doctrine. The language mentions neither the police nor the taxing power. Nor does the language expressly waive the state's right to impose future taxes or fees on [Petitioners] or their products, or expressly waive the state's right to further regulate the cigarette industry in the future.

Pet. App. 21a.[9] This reasoning is fully consistent with *Winstar*. *See* 518 U.S. at 878-79.

Confronted with Petitioners' claim that the Settlement Agreement surrendered state sovereign powers, the state court strictly construed relevant contract provisions and determined that they worked no such surrender. The court accordingly concluded that the Agreement did not "preclude legislative enactment of revenue measures directed at recovering future tobacco-related health care costs generally or the Health Impact Fee in particular." Pet. App. 24a. The state court's construction of the Agreement obviated the need to reach or analyze Petitioners' state or

[9] The full text of the State's Release quoted in this excerpt ("liabilities of any nature") is in Petitioners' appendix. *See* Pet. App. 10a; *see also supra* at 2-3.

federal contract clause arguments. *See* Pet. App. 19a, n.6 ("the unmistakability doctrine serves the dual purposes of limiting contractual incursions on a State's sovereign powers and of avoiding difficult constitutional questions about the extent of State authority to limit the subsequent exercise of legislative power. It serves both of those salutary purposes here. . . . ") (internal quotation marks and citation omitted).[10]

In addition to being manifestly correct, the state court's decision is fully consistent with this Court's Contract Clause jurisprudence. Most importantly, the state court's decision here does not – as Petitioners wrongly assert – allow states to breach contracts that are found not to surrender sovereign powers. *See, e.g.*, Pet. at 10, 16 (so alleging).

A brief discussion focusing on two of this Court's cases is sufficient to illustrate the point. In the first case, *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982), the Court considered whether long-term mineral leases between the Jicarilla Apache Tribe and non-Indian petroleum producers precluded the Tribe from later imposing a severance tax on petroleum produced by the lessees. *Id.* at 133. Twenty-one non-Indian petroleum producers ("lessees") entered into proprietary mineral leases with the Tribe granting them " 'the exclusive right and privilege to

[10] In addition to the Contract Clause challenges, the Minnesota Supreme Court was confronted with constitutional issues involving the separation of powers and the Minnesota Constitution's express prohibition against contracting away the taxing power. Resp. App. 66a-69a. The Governor, as amicus, also asserted that Petitioners' proposed constructions implicated state constitutional limits on the state attorney general's authority to contractually restrict the state's future exercise of sovereign powers. *See* Resp. App. 99a-105a.

drill for, mine, extract, remove, and dispose of all the oil and natural gas deposits in or under' the leased land. . . . " *Id.* at 135; *see also id.* at 145 (noting "the Tribe's role as commercial partner" in leases); *id.* at 146 (characterizing the leases as "the sovereign's commercial agreements"). The Tribe subsequently passed an ordinance "imposing a severance tax on oil and gas produced on tribal land." *Id.* at 135-36. The lessees "sought to enjoin enforcement of the tax by either the tribal authorities. . . ." *Id.* at 136. The federal district court permanently enjoined enforcement of the tax, but the court of appeals reversed. *Id.* This Court affirmed.

The Court concluded that the absence of any reference to taxation in the leases did not impair the Tribe's taxing authority.[11] The Court explained that "[c]ontractual arrangements remain subject to subsequent legislation by the presiding sovereign," *id.* at 147 (citations omitted), and that "sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." *Id.* at 148. The Court emphasized that this subsisting sovereign authority is unaffected by proprietary agreements: "Even where the contract at issue requires payment of a royalty for a license or franchise issued by the governmental entity, the government's power to tax remains unless it 'has been specifically surrendered in terms which admit of no other

[11] The Court first concluded that the Tribe's inherent authority to impose the severance tax was not affected by the Tribe's status as the lessor of mineral rights. "The mere fact that the government imposing the tax also enjoys rents and royalties as the lessor of the mineral lands does not undermine the government's authority to impose the tax." *Id.* at 138.

reasonable interpretation.'" *Id.* at 148 (quoting *St. Louis v. United R. Co.*, 210 U.S. 266, 280 (1908)). Applying the unmistakability doctrine, the Court pointedly refused to infer waiver of the Tribe's taxing power from silence. "To presume that a sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in a commercial agreement turns the concept of sovereignty on its head. . . . " *Id.* at 148.[12]

Merrion confirms that the Minnesota court's decision is consistent with this Court's application of the unmistakability doctrine. *See Winstar*, 518 U.S. at 876-77 (discussing this Court's cases applying the doctrine, including *Merrion*). Here, as in *Merrion*, a government entity entered into a proprietary agreement with private parties. Like the leases in *Merrion*, the Settlement Agreement in this case is silent about the state's taxing power. As did this Court in *Merrion*, the state court in this case applied the unmistakability doctrine and refused to infer a waiver of sovereign power from silence or ambiguity. In both cases, the unmistakability doctrine served its intended purposes of protecting government regulatory authority "and of avoiding difficult constitutional questions about

[12] Petitioners seek this very inversion, for they suggest that a state must – even when entering proprietary agreements – *expressly reserve* the power to legislate. *See* Pet. at 10 (challenging state's right to enact legislation "that is not expressly and specifically barred by the contract"). As *Winstar* noted, however, the dispositive question for unmistakability purposes is not whether the contract *reserves* sovereign power; it is instead whether the contract unmistakably *waives* such power. *See* 518 U.S. at 877-78.

the extent of state authority to limit the subsequent exercise of legislative power." *Winstar*, 518 U.S. at 875.[13]

Murray v. Charleston demonstrates the more general proposition that a state never has the power to breach its contracts, proprietary or otherwise. This Court held in *Murray* that the Contract Clause prohibited the City of Charleston from using legislative power to reduce the interest rate it had previously promised to pay to holders of municipal stock certificates. 96 U.S. 432, 444 (1877).

In *Murray*, the City of Charleston issued municipal stock certificates that provided for payment by the city of principal plus six percent interest. *Id.* at 439. The city later passed ordinances: (a) imposing a two-percent tax on real and personal property, and (b) ordering the city treasurer to pay four rather than six percent interest to stockholders, purportedly as a means of collecting the two-percent tax. *Id.* Plaintiff Murray brought an action under the Contract Clause complaining "that the city has not fully performed its contracts according to their terms, that it has paid only four per cent interest instead of six per cent, which it promised to pay. . . ." *Id.* at 442. The city responded that it "possessed the power of taxation when the contracts were made, that by the contracts the city did not surrender this power, that, therefore, the contracts were subject to its possible exercise, and that the city ordinances were only an exertion of it." *Id.* at 444.

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[13] Although the original purpose of the unmistakability doctrine was "avoidance" of Contract Clause issues, the Court has since applied the doctrine to avoid addressing limitations on government authority "independent of the Contract Clause." *See Winstar*, 518 U.S. at 875-76.

The Court framed the issue as whether the ordinances "did impair the obligation of the city's contract with the plaintiff." *Id.* at 443. The Court noted that "[t]he solution of this question depends upon a correct understanding of what that obligation was." *Id.* The Court found that the city had undertaken to pay plaintiff six percent interest, and that the contract "contained no reservation or restriction of the duty described." *Id.* The ordinances, however, purported to reduce the interest rate payable by the city from six to four percent. *Id.* Finding a "manifest" impairment of the city's payment obligation, *id.*, the Court invalidated the ordinances under the Contract Clause. *Id.* at 448.

Importantly, the Court did not "question the existence of [the city's] power to levy taxes as claimed, nor the subordination of contracts to it. . . . " *Id.* at 444. The issue, however, was not whether the city could levy the property tax, but was instead whether it could use legislative authority to alter its contractual obligation to pay stockholders six percent interest. The Court strongly affirmed the city's power to levy the property tax and collect it in the normal manner, holding that the city

> may undoubtedly tax any of its creditors within its jurisdiction for the debt due to him, and regulate the amount of the tax by the rate of interest the debt bears, if its promise be left unchanged. A tax thus laid impairs no obligation assumed. It leaves the contract untouched.

Id. at 445. The city could not, however, use its taxing power to "convert its undertaking to pay a debt bearing six per cent interest into one bearing only four." *Id.* at 447. Under the Contract Clause, the city could not "by its own ordinances, under the guise of taxation, relieve itself from

performing to the letter all that it has expressly promised to its creditors." *Id.* at 448.[14]

The state court's decision in this case is consistent with *Murray*, and does not allow states to breach contracts, proprietary or otherwise. As in *Murray*, the state court began its state Contract Clause analysis by determining the exact nature of the contractual obligation in question. *See* Pet. App. 9a. As in *Murray*, the state court recognized that contracts generally remain subject to a sovereign's taxing and police powers. *See* Pet. App. 14a-16a. And as in *Murray*, the court determined whether the state's obligation had been impaired by the subsequent exercise of legislative power. *See* Pet. App. 24a-25a. Although this Court invalidated the ordinances in *Murray*, whereas the state court upheld the HIF, this does not mean that the state court was unwilling to enforce the Contract Clause. It shows only that no contractual obligation undertaken by the state was impaired by imposition of the HIF.

Petitioners' assertion that this decision "conflicts with nearly 130 years of this Court's Contract Clause precedent," Pet. at 10, reflects a misunderstanding of both that precedent and the unmistakability doctrine's part therein. Although the states in both *Merrion* and *Murray* retained all of their sovereign powers, neither state was allowed to use those powers to breach contracts. Here, likewise, the State's retention of sovereign powers does not confer

[14] Petitioners wrongly assert that the City of Charleston breached its contract "by levying a tax." *See* Pet. at 12. This is plainly incorrect. The *Murray* Court made clear that the city could levy and collect the tax without violating its contract, so long as the city honored its contractual obligation to pay stockholders six percent interest before attempting to collect the tax. *See* 96 U.S. at 445-46.

authority to breach the Agreement. In any event, Petitioners' claim rests firmly on the erroneous theory that the State of Minnesota *failed to retain* its sovereign powers, a theory expressly rejected by the unmistakability doctrine.

The Contract Clause prevents states from using legislative power to substantially modify contracts to which they are parties. The unmistakability doctrine does not in any way vitiate this protection. Instead, the doctrine is a rule of contract construction requiring that government obligations be strictly construed so as to limit the extent to which the Contract Clause curtails state regulatory powers. Government contracts – once properly construed – receive the full measure of Contract Clause protection. Petitioners' assertion that the state court's decision allows states to impair contracts is incorrect, and should be rejected.

III. THIS COURT SHOULD DECLINE REVIEW BECAUSE THE PRESENT CASE DOES NOT PROVIDE A VEHICLE FOR RESOLVING ANY CONFUSION THAT MAY EXIST AMONG THE LOWER COURTS CONCERNING APPLICATION OF THE UNMISTAKABILITY DOCTRINE AND THE MEANING OF *WINSTAR*.

The Court should decline review because the present case plainly implicates the unmistakability doctrine and therefore does not provide a vehicle for resolving any confusion that might exist among the lower courts concerning its proper application. As was shown above, this case is quite similar to *Merrion*. *See supra* at 18-21. In both cases, non-governmental contracting parties specifically alleged that a disputed contract prevented a sovereign from enacting or enforcing laws. *Merrion*, 455 U.S. at

136; Pet. App. 10a, 12a, 18a. There is simply no question that the doctrine applies under these circumstances. *See Winstar*, 518 U.S. at 880; *see also id.* at 878-79 (doctrine applies "when the Government is subject either to a claim that its contract has surrendered a sovereign power . . . or to a claim that cannot be recognized without creating an exception from the exercise of such a power. . . . ").[15]

The Court should decline review for additional reasons as well. First, Petitioners perceive confusion among the lower courts principally because Petitioners themselves misread the plurality opinion in *Winstar*. The plurality does not, as Petitioners assert, make application of the unmistakability doctrine turn on a "two-step inquiry" that begins with whether the disputed contract is "proprietary." *See* Pet. at 16-17 (positing two-step inquiry).

As an initial matter, the plurality specifically *held* that "application of the doctrine . . . turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power of the Government." *Winstar*, 518 U.S. at 879. The plurality noted that, "[s]ince the criterion looks to the effect of a contract's enforcement, the particular remedy sought is not dispositive . . . . " *Id.*

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[15] One lower court, although noting some uncertainty about how the doctrine might apply in particular circumstances, commented: "It is clear, however, that one of the basic principles underlying the doctrine is the concern that it would be unreasonable to presume, in the absence of an express contractual provision, that a sovereign intended a contractual waiver of a basic sovereign power." *Tamarind Resort Assocs. v. Gov't of the Virgin Islands*, 138 F.3d 107, 112 (3d Cir. 1998) (citing *Winstar*, 518 U.S. at 920-21 and *Merrion*, 455 U.S. at 148). The *Tamarind* court's citation to *Merrion* demonstrates that the lower courts have no doubt about the doctrine's application to paradigmatic situations like the one presented in this case.

Application of the doctrine "will therefore differ according to the different kinds of obligations the Government may assume and the consequences of enforcing them." *Id.* at 880. After setting forth examples in which the doctrine clearly would and would not apply, the plurality noted: "Between these extremes lies an enormous variety of contracts including those under which performance will require exercise (or not) of a power peculiar to the Government." *Id.* Rather than establishing the "two-step inquiry" perceived by Petitioners, the plurality articulated governing principles, then illustrated that application of those principles to "an enormous variety of contracts" would require a sensitive case-by-case adjudication. *Id.*

More importantly, Petitioners are simply incorrect in asserting that application of the doctrine turns on whether a contract is proprietary. *See, e.g.*, Pet. at 16. As was discussed above, this Court has itself applied the doctrine to a proprietary contract. *See, e.g.*, *Merrion*, 455 U.S. at 145-48. Moreover, as Petitioners themselves note, two Circuit Courts have applied the doctrine to proprietary contracts since the Court decided *Winstar*. *See* Pet. at 18 (citing *Tamarind Resort Assocs. v. Gov't of the Virgin Islands*, 138 F.3d 107, 109, 112 (3d Cir. 1998) and *Yankee Atomic Elec. Co. v. United States*, 112 F.3d 1569, 1579 (Fed. Cir. 1997), *cert. denied*, 524 U.S. 951 (1998)). The state court's application of the doctrine here is consistent with these authorities. The lower courts plainly understand that, under the proper circumstances, the doctrine applies to proprietary contracts. There is no confusion on this point; Petitioners are simply wrong.

Second, even if there is some confusion among the lower courts concerning how *Winstar* or the unmistakability doctrine should apply *to factual situations not presented*

here, this case obviously provides no occasion to address such confusion. Petitioners cite a handful of cases in which lower courts indicate some uncertainty about how either *Winstar* or the unmistakability doctrine should apply to certain classes of contracts. *See* Pet. at 18-19 & n.7; *see also Tamarind Resort Assocs.*, 138 F.3d at 112 ("It is somewhat unclear . . . as to the type of contract to which the unmistakability doctrine applies."). They cite academic authorities to the same effect. *See* Pet. at 19-20. Given the absence of a majority opinion in *Winstar* and the fact that the Court was somewhat fragmented, it is not surprising that some lower courts feel some uncertainty. This case, however, which involves a paradigm application of the unmistakability doctrine, furnishes no occasion to clarify how the doctrine should apply to non-paradigmatic facts.

An example may be useful. In *Winstar* a four-justice plurality[16] determined that the unmistakability doctrine does not apply where, as in *Winstar*, the disputed contract could be "reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of" government power. *Winstar*, 518 U.S. at 880. Three justices who concurred in the judgment disagreed with the latter restriction, and would have held the doctrine applicable even to so-called risk-shifting agreements. *See id.* at 919-20 (Scalia, J., concurring in the judgment).[17] The two dissenting justices would have held the doctrine applicable to all government

[16] Justice Souter, joined by Justices Stevens, O'Connor and Breyer.

[17] Joined by Justices Kennedy and Thomas.

contracts including risk-shifting agreements. *See id.* at 926-27 (Rehnquist, C.J., dissenting).[18]

A principal point of disagreement in *Winstar*, then, was whether the unmistakability doctrine applies to risk-shifting agreements.[19] The concurring and dissenting justices would have held in the affirmative, and would thus have given the doctrine broader application than did the plurality. It is therefore to be expected that lower courts are somewhat uncertain about the doctrine's application to risk-shifting agreements. That issue is not presented here, however. The state court correctly determined that the Settlement Agreement in this case is not a risk-shifting agreement, and that Petitioners' proposed construction of the Agreement would directly limit state sovereign powers. *See* Pet. App. 10a, 12a, 18a. Under the circumstances, it appears that all nine *Winstar* justices would have applied the unmistakability doctrine to the present case. Plainly, this case does not provide a suitable vehicle for clarifying the law, even assuming such clarification is necessary.

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[18] Joined by Justice Ginsburg.

[19] The lower courts plainly perceive this disagreement. *See, e.g., Tamarind Resort Assocs.*, 138 F.3d at 112; *Yankee Atomic Elec. Co.*, 112 F.3d at 1578-79; *Gen. Dynamics Corp. v. United States*, 47 Fed. Cl. 514, 535-36 (2000).

CONCLUSION

For all the foregoing reasons, the Petition of Philip Morris USA, Inc. and the joining Petitioners should be denied.

Dated December 7, 2006

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vs.

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ARGUMENT

I. THE LANGUAGE AND CONTEXT OF THE AGREEMENT DEMONSTRATE THAT THE PARTIES INTENDED IT TO BE A MUTUAL RELEASE OF ADJUDICATORY CLAIMS ONLY.

The parties propose two very different readings of the State's Release. This shows that the provision requires judicial construction. In its *de novo* review of the Agreement, the Court should prefer the State's construction, which will completely resolve this case. The State's reading preserves the plain meaning of the Agreement's terms, honors the context in which those terms appear, comports with settled rules of contract construction, and harmonizes the State's Release with the balance of the Agreement. As will be shown, Defendants' reading of the Release does none of these things.

A. The Court Should Reject As Unsound Defendants' Construction Of The State's Release.

Defendants begin their rather cursory construction argument with an excerpt of the State's Release that is both truncated and elliptical. The truncation isolates the phrase "liabilities of any nature whatsoever" (the "Liabilities Phrase"), *see* Defs.' Br. at 19, and allows Defendants to assign it an expansive meaning starkly incompatible with context. *Id.* at 22 & n.7. The ellipsis artificially places the

Liability Phrase alongside the word "statutory," allowing Defendants to assert that the conjoined terms mean "legislation." *Id.* at 20, 22-23.

Defendants rely on this exaggerated version of the Liability Phrase throughout the rest of their brief. *See, e.g.*, Defs.' Br. at 28, 33, 34. Most importantly, Defendants assert that the State's Release "expressly releases the precise liability that the Health Impact Fee seeks to impose," *id.* at 19, and they argue that it "defin[es] 'claims' in the broadest possible terms to include not just judicial liability, but 'liabilities of any nature whatsoever' including 'statutory' liability." *Id.* at 19-20.

By isolating the Liabilities Phrase, Defendants improperly suppress context. *See Motorsports Racing Plus, Inc. v. Arctic Cat Sales, Inc.*, 666 N.W.2d 320, 324 (Minn. 2003) (holding that words or phrases should not be "isolated from their context"). The Liabilities Phrase is just one item in a *list* of "claims" in the State's Release. That list reads, in full, as follows:

> civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims"). . . .

App. at 50-51. Settled rules of construction make clear *why* context is critical.

The most important term here is the one defined – "claims" – since it is used throughout the balance of the Agreement. Under the rule of *ejusdem generis*, the term "claims" must be interpreted to include only the sorts of

items that precede it. *See* Minn. Stat. § 645.08(3) (2004) ("general words are construed to be restricted in their meaning by preceding particular words"); *Employers Liability Assur. Corp. v. Morse*, 111 N.W.2d 620, 624-25 (Minn. 1961) (applying rule of *ejusdem generis* to interpret contract). As the State has already shown, the preceding items all relate to adjudication. *See* State's Br. at 15-16. Although Defendants correctly note that the Agreement does not use the term "adjudicatory claims," *see* Defs.' Br. at 19, proper attention to linguistic context reveals that this is an accurate *interpretation* of the term "claims" *as it appears in the State's Release*. It is also consistent with the common and established meaning of the term "claims." *See* State's Br. at 15-17 & n.9.

Context is equally important for properly construing the Liabilities Phrase, which Defendants assign the broadest possible meaning. *See* Defs.' Br. at 22 & n.7. Under the doctrine of *noscitur a sociis*, a phrase capable of several meanings is defined by the words with which the phrase is associated. *See, e.g., Fletcher v. Scott*, 277 N.W. 270, 272-73 (Minn. 1938); *accord Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). Because the terms surrounding the Liabilities Phrase all pertain to adjudication, the Liabilities Phrase does so as well. *See* State's Br. at 19. "[W]hen two or more words are grouped together and ordinarily have a similar meaning, but are not equally comprehensive, the general word will be limited and qualified by the special word[s]." *State v. Suess*, 52 N.W.2d 409, 415 (Minn. 1952). This rule should be applied here to give the Liabilities Phrase its intended scope. *See Utility Elec. Supply, Inc. v. ABB Power T & D Co.*, 36 F.3d 737, 740 (8th Cir. 1994) (noting that doctrine of *noscitur a sociis* is wisely applied to avoid giving statutes unintended

breadth); *Mienes v. Lucker Sales Co.*, 246 N.W. 667, 668 (Minn. 1933) (applying doctrine to limit contract provision to intended scope).

In addition to violating these rules of construction, Defendants' overly expansive interpretation of the Liabilities Phrase is inconsistent with the parties' drafting practice. As the State has already observed, the parties included an additional term – "civil penalties" – in the State's Release. *See* State's Br. at 27. If Defendants were correct that the parties intended "liabilities" *as used in the State's Release* to have its broadest possible meaning, the addition of "civil penalties" would have been entirely unnecessary. Such penalties would plainly have been embraced by the Liabilities Phrase. Because the parties added this extra provision, they clearly did not have in mind Defendants' expansive construction.

In direct contravention of these rules of construction, Defendants combine the disparate terms "liabilities" and "statutory" in an attempt to make "claims" mean "legislation." *See* Defs.' Br. at 22-23. The Court should reject this attempt to expand the State's Release.

First, it requires the improbable inference that, in a section releasing "claims," these sophisticated parties sought to create an exemption from future "legislation," and did so obliquely by using two other words, "liabilities" and "statutory," that reside is two separate clauses. Second, since the Agreement frequently used the word "legislation," *see* State's Br. at 17-18, it requires the conclusion that the parties – without any apparent reason – referred to "legislation" in different ways in different parts of the Agreement. Finally, it is inconsistent with the obvious conclusion that "statutory" claims refers to the very sort of

statutory causes of action asserted in the State Tobacco Lawsuit. *See* App. at 28-36 (State's common law and statutory claims).

When the parties actually addressed legislation in the Agreement, they used that very word. *See* State's Br. at 17-18. Moreover, had the parties wished to provide that Defendants would be exempt from legislation imposing taxes or fees, they would simply have said so. They did not. This Court should conclude that the parties intended the Agreement to work a mutual release of adjudicatory claims only. *See id.* at 13-22.[1]

B. Proper Construction Of The State's Release Undercuts Defendants' Subsidiary Arguments.

1. Because Legislation Falls Outside The Scope Of The Agreement, The Legislature Did Not Unilaterally Alter The Agreement Or Nullify Any Benefit By Imposing The HIF.

Because the Agreement applies exclusively to adjudicatory claims – and not to legislation – the Legislature did not unilaterally alter the Agreement by imposing the HIF. *See* Defs.' Br. at 17, 20-21. Defendants themselves emphasize that "*any* legislation that raises revenue will help offset State health care costs from tobacco." *Id.* at 30 (emphasis in original). It is undisputed that on the very

[1] Each use of the term "claims" in the Agreement and Consent Judgment, again when considered in context, confirms that "claims" refers to *adjudicatory* claims. *See, e.g.*, App. at 37, 39, 43 (§ II.A), 50 (§ III.A), 80 (§ X).

day the Agreement was executed, the Legislature could have quadrupled the cigarette excise tax to offset state healthcare costs. The district court specifically noted that "the Legislature is free to raise revenue by means of a [cigarette] tax, and all parties agree that there would be no basis to override such a tax. . . . " App. at 15.

Defendants thus understood when they executed the Agreement that their products remained subject to legislative exactions. They also appreciated *then* what they say *today* – that the revenue the State raised could be *used* by the State to offset healthcare costs. This conclusively demonstrates that Defendants assumed the risk that the Legislature would impose additional exactions upon their products.[2] Their argument thus amounts to this: (a) the Legislature is free to impose additional exactions upon their products; (b) the State can *use* any revenue generated to offset state healthcare costs; but (c) the Legislature cannot *declare* that the exaction is imposed for this purpose. This cannot be correct. If the Agreement left the Legislature free to tax Defendants' products to offset state healthcare costs, it left the Legislature free to declare its purpose.

Nor does imposing the HIF on Defendants' Distributors nullify the only tangible benefit Defendants received under the Agreement. *See* Defs.' Br. at 15-16, 21, 26. When negotiating and securing a waiver of all state "claims," Defendants fully appreciated that their products would remain subject to legislative exactions. They willingly

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[2] Defendants' contrary assertion that the State assumed the risk that future legislation would be unenforceable is addressed below. *See infra* at 15.

accepted this risk, however, because they perceived that their very existence was threatened by State-initiated lawsuits, and Minnesota's in particular.[3] A release of adjudicatory claims eliminated this risk, and left Defendants free to oppose legislative impositions in the political arena as they had done so successfully in the past.[4]

2. The HIF Is Not A "Claim" For State Healthcare Costs.

The Legislature placed the incidence of the HIF, like that of the cigarette excise tax, upon the distribution and sale of cigarettes. *See* State's Br. at 40 & n.24. Thus, the HIF, like the excise tax, is a legislative exaction upon a commercial activity. The Legislature's declaration that the *purpose* of the HIF is to recover state healthcare costs associated with smoking does not convert the HIF into a "claim" for healthcare costs, "statutory" or otherwise. *See* Defs.' Br. at 30. As Defendants themselves note, all state revenues defray state healthcare costs. The HIF is no

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[3] An R.J. Reynolds press release issued the day the Agreement was signed perfectly illustrates the value Defendants placed on receiving a release of legal claims: "This country has to decide whether one court, like Minnesota, should have the power to bring the industry to the brink of bankruptcy with all the negative implications of such a decision." *See* R.J. Reynolds, "R.J. Reynolds Issues Minnesota Statement," May 8, 1998, http://www.rjrt.com/newsroom/resourcesRJRTview.asp?postID=884 (last visited March 9, 2006).

[4] There is no merit to Defendants' assertion that the Agreement is somehow special because it was not "conditioned on a single payment" and released future claims. *See* Defs.' Br. at 20. Many settlement agreements provide for multiple payments. *See Minnesota Def. Lawyers Ass'n Release Deskbook* 235-51 (Eric J. Magnuson & Stephen O. Plunkett eds. 1998) (discussing structured settlements). Moreover, many agreements contain provisions releasing future claims. *See, e.g., id.*, App. of Forms at F-49, F-54.

more a "claim" for healthcare costs than is the excise tax. Each is a legislative exaction upon the commercial activity of distributing cigarettes, and a distributor's liability for each is measured exclusively by the extent to which the distributor engages in that activity.

If a distributor failed to pay the HIF, were assessed by the Commissioner, appealed, and thus compelled the State to litigate unpaid amounts, the State would proceed exclusively by proving how many packs of cigarettes the distributor had received, just as it would in pursuing unpaid excise tax amounts. The State would *not* offer evidence of state healthcare costs, which would be utterly irrelevant. In either case, the State would be pursuing *unpaid taxes or fees*. It would not be asserting a "claim" for state healthcare costs.

C. Because The Agreement Does Not Surrender The Legislature's Power To Impose An Exaction On The Distribution Of Cigarettes, Imposing The HIF Does Not Breach Or Impair The Agreement.

This case does not involve a Contracts Clause violation because the Act does not attempt to *alter* the obligations of the Agreement. *See* State's Br. at 21 (essence of impairment is alteration). Indeed, the United States Supreme Court found Contracts Clause violations in the two cases discussed by Defendants specifically because legislation *changed the obligations* of existing contracts. *See* Defs.' Br. at 26; *United States Trust Co. v. New Jersey*, 431 U.S. 1, 25-27 (1977) (finding violation where legislature repealed statutory covenant with bondholders); *Murray v. Charleston*, 96 U.S. 432, 443 (1877) (finding violation where city stock certificates promised payment of

six percent interest, but where subsequent ordinance commanded city clerk to withhold, rather than pay, one-third of said interest).

Even if this Court were to conclude that the HIF qualifies as a released "claim" under the Agreement (it does not), this would mean only that the Legislature *breached* the Agreement by imposing the HIF. It would show a *violation* – rather than an *attempted alteration* – of the Agreement. Thus, it would not establish a Contracts Clause violation. As the United States Court of Appeals for the Seventh Circuit has explained: "[W]hen a state repudiates a contract to which it is a party it is doing nothing different from what a private party does when the party repudiates a contract; it is committing a breach of contract. It would be absurd to turn every breach of contract by a state or municipality into a violation of the federal Constitution." *Horwitz-Matthews, Inc. v. City of Chicago*, 78 F.3d 1248, 1250 (7th Cir. 1996) (Posner, J.). Because the Act does not alter the Agreement, there is no impairment. There is no breach, moreover, because the HIF is not a released "claim" under the Agreement.

D. The Scope Of The State's Release Must Be Construed Consistent With The State's Status As A Private Party.

Defendants urge the Court to treat the State "the same way it treats any other contracting party." Defs.' Br. at 18. They note that the State Tobacco Lawsuit was initiated "to vindicate a proprietary interest," *id.* at 6, and they observe that "[a] state may lay aside its sovereignty" when contracting with private parties. *Id.* at 18 n.6. Defendants actually treat the State as a private party in name only, however.

Although Defendants deny claiming that the State "'contracted away' its power to legislate," Defs.' Br. at 31, they later insist that the Agreement binds the State "in all of its manifestations." *Id.* at 36. These assertions are plainly inconsistent, since binding the entire State surely encompasses the State's "power to legislate." In addition, Defendants expressly allege that the Agreement bars the State from *enforcing* its laws. *Id.* at 36-37. Defendants thus stretch the State's Release to bind the State in its sovereign capacity. Defendants' entire approach is incorrect because the State proceeded in its proprietary capacity throughout the State Tobacco Lawsuit. The State *qua* private party cannot bind the State *qua* sovereign.

1. The State Acted In Its Proprietary Capacity When Executing The Agreement.

The State agrees that it acted in its proprietary capacity when bringing and settling the State Tobacco Lawsuit. *See* Supp. App. at 56-57. The State's private-party status must therefore be respected when construing the scope of its release. This principle of consistency is reflected in longstanding Supreme Court precedent:

> [T]he government entering into a contract stands not in the attitude of the government exercising its sovereign power of providing laws for the welfare of the State. The United States as a contractor are not responsible for the United States as a lawgiver. . . . In this court, *the United States can be held to no greater liability than other contractors in other courts.*

Deming v. United States, 1 Ct. Cl. 190, 191 (1865) (emphasis added). *See also United States Trust Co. v. New Jersey*,

431 U.S. 1, 25 n.23 (1977) (concluding that when governments act as private parties rather than as sovereigns, "[t]hey come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons."); *Jones v. United States*, 1 Ct. Cl. 383, 384-85 (1865) ("In this court the United States appear simply as contractors; and they are to be held liable only within the same limits that any other defendant would be in any other court.").

Because the State must, like Defendants, be treated as a private party, the Agreement's two release provisions must be construed as coextensive. More specifically, the State's Release cannot be read as surrendering sovereign legislative authority not possessed by the State in its proprietary capacity. *See Jones*, 1 Ct. Cl. at 384 ("The two characters which the government possesses as a contractor and as a sovereign cannot be thus fused.").

This same principle of consistent party status defeats Defendants' argument that the Liabilities Phrase *generally* covers civil claims, but in the State's Release covers more. *See* Defs.' Br. at 21. The Court should reject Defendants' attempt to expand that phrase (or the term "claims") to cover the State's sovereign enforcement authority.

2. Because The State Executed The Agreement In Its Proprietary Capacity, It Released Through The Agreement Only The Legal Claims It Held In That Capacity.

Acting in its proprietary capacity, the State commenced the State Tobacco Lawsuit, which asserted common law and statutory claims. All of these claims involved

the invocation of common law or statutory rights equally available to private parties.[5]

Acting again in its proprietary capacity, the State later settled its lawsuit and entered the Agreement. As might any private party, the State made a binding contractual promise to never again assert specified "claims" against Defendants for healthcare costs. In releasing these claims, the State reasoned, as might any private party, that its proprietary interest would be better served by entering the Agreement than by preserving its claims. Like any private party, then, the State promised that it would never again assert "claims" based on rights it possessed in its proprietary capacity (such as a right derived, for example, from the Deceptive Practices Act).

When the State acts in its sovereign capacity, it does not invoke rights and assert "claims." Instead, it exercises the sovereign power to enact and enforce laws. Such power is possessed by neither private parties nor the State acting in its proprietary capacity. The State as sovereign, for example, *enforces* the tax laws administratively by

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[5] In *State by Humphrey v. Philip Morris Inc.*, 551 N.W.2d 490 (Minn. 1996), this Court specifically noted that a private right of action existed for each of the statutory claims the State asserted in the present case:

> In their joint complaint, the State and Blue Cross allege violations of Minnesota's antitrust statute as well as consumer protection statutes relating to consumer fraud, unlawful and deceptive trade practices, and false advertising. Each of these statutes contains specific authorizations for suit *and each creates a private cause of action for any party injured directly or indirectly by a violation of the statute.*

Id. at 495 (emphasis added); *see also id.* at 495-97 (discussing statutory basis for private right of action for each enumerated statutory claim).

auditing taxpayers and assessing sums owed. And, if taxpayers appeal, the State defends its enforcement actions in a judicial setting. *See, e.g.*, Minn. Stat. §§ 270C.03 (Supp. 2005) (Commissioner's powers generally), 289A.35 (2004 & Supp. 2005) (Commissioner's power to assess), 271.06, subd. 1 (Supp. 2005) (taxpayer may appeal orders of Commissioner to tax court).

The State *qua* sovereign has an affirmative duty to enforce the laws. *See, e.g.*, *State ex rel. Decker v. Montague*, 262 N.W. 684, 689 (Minn. 1935) ("The Governor, under his oath of office, is bound to enforce the law. . . . "). Although the Executive has substantial enforcement discretion, the exercise of such discretion involves a calculus completely different from that the State uses when acting in its proprietary capacity. The question is not whether a given "claim" should be exchanged for some consideration. Enforcement decisions instead turn on such factors as "the strength of the case, the prosecution's general deterrence value, the Government's enforcement priorities, and the case's relationship to the Government's overall enforcement plan." *Wayte v. United States*, 470 U.S. 598, 607 (1985). *See also 421 Corp. v. Metro. Gov't of Nashville*, 36 S.W.3d 469, 480 (Tenn. 2000) (recognizing in context of civil enforcement that "practical realities require the allocation of limited public resources.").

When the State released its "claims" through the Agreement, it did not surrender its entirely separate sovereign power to enact and enforce laws. Because the State must be treated as one of two private parties to the Agreement, then, absent a clear indication otherwise, the Agreement's two release provisions must be construed to have equal meaning. *See, e.g., Thompson v. Amoco Oil Co.*, 903 F.2d 1118, 1121 (7th Cir. 1990) ("Unless a contrary

intent is evident, words used in one sense in one part of a contract are deemed of like significance in another part."). Treating the State as a private party compels the conclusion that the State released no more than did Defendants – the option to pursue rights-based legal claims.

II. THE TERM "CLAIM" CANNOT BE INTERPRETED TO INCLUDE LEGISLATIVE EXACTIONS BECAUSE THE STATE'S RELEASE OF CLAIMS DOES NOT SURRENDER THE STATE'S SOVEREIGN POLICE AND TAXING POWERS "IN LANGUAGE AND TERMS TOO CLEAR TO ADMIT OF DOUBT."

A. The Unmistakability Doctrine Is A Canon Of Strict Contract Construction Rather Than A Contract Defense, And It Plainly Applies To The Facts Presented.

Defendants assert that the State invokes the unmistakability doctrine *as a defense* to its alleged breach of the Agreement. *See, e.g.*, Defs.' Br. at 31-33. As the State's principal brief makes plain, however, the unmistakability doctrine is a canon of strict construction that courts use to determine what government contracts *mean* – to determine what they actually promise. *See* State's Br. at 22-25. The doctrine is *not* a justification or excuse for a breach of promises clearly made, and is not invoked by the State for that purpose.

Defendants next assert that the doctrine does not apply here, purportedly because their construction of the Agreement does not involve the surrender of sovereign power. *See* Defs.' Br. at 16, 31, 33, 35. This is incorrect. The United States Supreme Court has explained that application of the doctrine "turns on whether enforcement of the contractual obligation alleged would block the exercise of a

sovereign power of the Government." *See United States v. Winstar Corp.*, 518 U.S. 839, 879 (1996) (plurality opinion).

Invoking the Agreement, Defendants obtained a lower court Order enjoining the Commissioner from enforcing against Defendants' Distributors a valid Act of the Legislature. Defendants now ask this Court to affirm. Because Defendants assert that the Agreement bars the enforcement of a valid law, the doctrine unquestionably applies. *Id.* at 876-79 (discussing Court's own applications of doctrine); *cf. id.* at 881 (doctrine not applicable where all post-contract Congressional measures were fully enforced); *see also Gillam v. Sioux City & St. P.R. Co.*, 3 N.W. 353, 355 (Minn. 1879) (applying doctrine where railroad alleged that its charter prevented Legislature from passing law requiring railroad to build cattle fences). And, as shown in the State's principal brief, the doctrine plainly defeats Defendants' claim that the Agreement surrenders the Legislature's police or taxing powers. *See* State's Br. at 25-26.

Rather than admitting that their construction of the Agreement bars the Legislature from imposing, and the Commissioner from enforcing, the Act, Defendants attempt to reframe the issue. They thus contend that the State "assumed the risk that future legislation would . . . be unenforceable as to the Settling Defendants' products," Defs.' Br. at 33, and that "[s]uch an assumption of risk occurs whenever the State enters into a contract." *Id.* at 31. This is truly a distinction without a difference. As *Winstar* recognized, if a party contends that a contract bars the enforcement of a valid law, then that party is arguing that the contract surrenders sovereign power. *See Winstar*, 518 U.S. at 879. Tellingly, Defendants feel compelled to assert that the Agreement binds "the State *in all*

of its manifestations." *See* Defs.' Br. at 36 (emphasis added).

Defendants' assumption of risk argument stands the unmistakability doctrine on its head. Although the doctrine recognizes that the Contracts Clause limits a state's power to impair contracts through legislation, *see Winstar*, 518 U.S. at 874, it also requires that the surrender of sovereign power be stated in "unmistakable terms." *Id.* at 872. Defendants, in contrast, construe a conventional release of claims as creating a broad bar to future legislative and executive action, *see* Defs.' Br. at 15, 19-20, and they assert – without any authority – that contracts prevail over the enforcement of valid laws. *See id.* at 31, 33-34. The Court should reject this attempt to reverse the unmistakability doctrine.

B. The State Invokes The Separation Of Powers Not As A Contract Defense, But As Circumstantial Evidence That The Attorney General Did Not Surrender Legislative Authority.

As with the unmistakability doctrine, Defendants incorrectly assert that the State invokes the separation of powers *as a defense* to justify an alleged breach of the Agreement. *See* Defs.' Br. at 31, 32, 35-39. Instead, the State discusses the separation of powers because it is relevant to proper *construction* of the Agreement. *See* State's Br. at 27-30. Specifically, this constitutional principle furnishes circumstantial evidence that then-Attorney General Humphrey did not, as Defendants suggest, grant Defendants a prospective exemption from all legislative exactions on cigarettes that are used to fund state healthcare costs. *Id.* The Attorney General simply would not have entered a contract surrendering legislative authority

in direct contravention of the Minnesota Constitution. *Id.* Consequently, the Agreement should not be construed as though he did.

The parties themselves recognized that the Attorney General could not speak for the Legislature or promise legislative results. Section II.C of the Agreement provides in part that, "[t]he Attorney General will propose . . . that the Legislature appropriate to a foundation" certain listed funds. App. at 46. Although the Attorney General had the authority to bind the State "in all of its manifestations" *as to the assertion of claims*, the Agreement recognizes he could not bind the Legislature *concerning legislation*.

In addition, there is no substance to Defendants' argument that, even if the Attorney General lacked authority to surrender sovereign power, the Legislature acquiesced in the Agreement. *See* Defs.' Br. at 37-38. As an initial matter, the Legislature likely cannot acquiesce in a surrender of its powers. *See* State's Br. at 29 n.13; *Ketterer v. Indep. Sch. Dist. No. 1*, 79 N.W.2d 428, 436 (Minn. 1956) (no ratification where initial action lies outside scope of governmental body in first instance). In any event, this argument entirely begs the question. Even if evidence of acquiescence existed, Defendants could not show that the Legislature acquiesced *in their construction* of the Agreement. The State does not dispute that the Agreement is "binding and enforceable" as to the State's proprietary rights. Defs.' Br. at 38. It simply contends that Defendants misconstrue the Agreement to bind the State in its sovereign capacity.

III. In The Alternative, The Agreement Does Not Bar Imposition And Enforcement Of The HIF Because The Agreement Incorporates The Minnesota Constitution's Express Prohibition Against Contracting Away The Taxing Power.

Defendants try to finesse the tax/fee issue by repeating the claim that, under their interpretation of the Agreement, the State is not *really* surrendering its sovereign taxing power. *See* Defs.' Br. at 39. For the reasons set forth above, this claim should be rejected. *See supra* at 14.

Defendants next cite *Naftalin* for the proposition that a contract can have an "*indirect* effect" on the taxing power without violating Article X, Section 1 of the Minnesota Constitution (the "1906 Amendment"). *See* Defs.' Br. at 39 (emphasis in original) (citing *Naftalin v. King*, 90 N.W.2d 185, 191 (Minn. 1958)). *Naftalin* is inapposite, however. That case involved whether the State could contractually promise to fund bond payments, and thereby bind itself *to exercise its taxing power*. *Naftalin*, 90 N.W.2d at 190-91. This Court specifically distinguished that situation from a contract *surrendering* the taxing power, which it noted is expressly prohibited by the 1906 Amendment. *Id.* at 191. There is simply no support for Defendants' "indirect effect" argument. *See In re Minnehaha Parkway*, 209 N.W. 939, 940 (Minn. 1926) (holding that 1906 Amendment "was intended to prevent any impairment of the taxing power in any manner whatever").

The parties appear to agree, for the most part, on the standards relevant to determining whether a legislative imposition is a tax or a fee. *Compare* State's Br. at 33-36 *with* Defs.' Br. at 40. They disagree mostly on the application of those standards.

Defendants are wrong to assert that the HIF is a fee because there is a "direct relationship" between the HIF and state healthcare costs. *See* Defs.' Br. at 41-42. As an initial matter, distributors rather than smokers pay the HIF. Distributors, however, do not receive the state healthcare services the HIF allegedly funds. True fees are paid by those who receive services. *See Okeson v. City of Seattle*, 78 P.3d 1279, 1286 (Wash. 2003).

Defendants' claim fares no better even if economic burden rather than legal incidence is considered. Many people who smoke – perhaps the majority of them – will never cost the state a cent in healthcare expenditures. Many smokers, for example, have private employers and private insurers, etc. Consequently, there is no relationship at all, direct or otherwise, between the 75 cents a particular smoker pays on a pack of cigarettes and state healthcare costs.

In reality, the HIF is simply an excise tax on *all* smokers to fund the expenses that *some* smokers impose on the State. It is administered identically to the cigarette excise tax, and has no true regulatory purpose. *See* State's Br. at 38-40. The Legislature's twin expedients of including the HIF in the Ominbus Health and Human Services Bill and placing HIF proceeds into a special fund cannot convert the HIF into a fee for judicial purposes,[6] just as labeling the imposition a "fee" cannot. *See id.* at 33.

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[6] Segregating the proceeds of a tax into a special fund and earmarking them for a particular purpose do not convert a tax into a fee. *See* State's Br. at 41-42. All proceeds of Minnesota's gasoline excise tax, for example, must be placed into the Highway User Tax Distribution Fund. *See* Minn. Const. art. XIV, § 10. Those proceeds must be used "solely for highway purposes." Minn. Const. art. XIV, § 5. Nevertheless,

(Continued on following page)

CONCLUSION

For the above stated reasons, the State respectfully requests that this Court reverse the December 20, 2005 decision of the district court in its entirety.

Dated: _____

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this Court has held that the gasoline excise tax is a "special tax" on gasoline to fund state roadbuilding expenses. *See Amoco Corp. v. Comm'r of Revenue*, 658 N.W.2d 859, 872 & n.4 (Minn. 2003).

No. A05-2540

STATE OF MINNESOTA
IN SUPREME COURT

The State of Minnesota,
by Hubert H. Humphrey III,
its then Attorney General, *et al.*,

Petitioner,

vs.

Philip Morris USA, Inc., *et al.*,
and
A.H. Hermel Candy & Tobacco Co., *et al.*

Respondents.

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LEGAL ISSUES

I. Does the language and context of the 1998 Settlement Agreement demonstrate that the parties intended the Agreement to provide a mutual release of adjudicatory claims only?

- The district court ruled that the Agreement surrendered legislative powers as well as adjudicatory claims.

  Motorsports Racing Plus, Inc. v. Arctic Cat Sales, Inc., 666 N.W.2d 320 (Minn. 2003).

II. Did the State's release of "claims" in the Agreement surrender the Legislature's sovereign police and taxing powers "in language and terms too clear to admit of doubt"?

- The district court implicitly ruled in the affirmative.

  State v. Great N. Ry., 119 N.W. 202 (Minn. 1908).

  United States v. Winstar Corp., 518 U.S. 839 (1996).

  Minneapolis Gas Co. v. Zimmerman, 91 N.W.2d 642 (Minn. 1958).

III. Does the Agreement bar enforcement of the Health Impact Fee ("HIF") when the Agreement incorporates by operation of law the Minnesota Constitution's express prohibition against contracting away the Legislature's taxing power?

- The district court did not reach this issue.

  Minn. Const. art. X, § 1.

  Country Joe, Inc. v. City of Eagan, 560 N.W.2d 681 (Minn. 1997).

Ramaley v. City of St. Paul, 33 N.W.2d 19 (Minn. 1948).

IV. If the HIF cannot be enforced against Defendants' Distributors, does continued enforcement of the HIF against the Intervenors violate the Intervenors' equal protection rights?

- The district court ruled that continued enforcement of the HIF against Intervenors violates their equal protection rights.

Kolton v. County of Anoka, 645 N.W.2d 403 (Minn. 2002).

Lorillard Tobacco Co. v. Reilly, 533 U.S. 525 (2001).

Star Scientific, Inc. v. Beales, 278 F.3d 339 (4th Cir. 2002).

STATEMENT OF THE CASE

On May 8, 1998, the country's four largest tobacco manufacturers ("Settling Defendants" or "Defendants")[1] entered a Settlement Agreement with the State to resolve – before an empanelled jury could – the State's pending litigation. *See generally* Appendix ("App.") at 37-71 (Settlement Agreement dated May 8, 1998). On August 26, 2005, Defendants brought a motion in Ramsey County District Court to enforce that Agreement. *See* App. at 1-5[2]

[1] "Settling Defendants" include Phillip Morris USA, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation and Lorillard Tobacco Company.

[2] Defendants proceeded by motion because the Consent Judgment accompanying the Settlement Agreement provides that "[j]urisdiction of

(Continued on following page)

Nine of their distributors ("Defendants' Distributors") intervened without objection. Together, Defendants and their distributors asserted that the 2005 Health Impact Fee ("HIF") – a legislatively imposed exaction on the distribution of cigarettes – is a "released claim" under the Agreement and, consequently, could not be enforced against them.

The Council of Independent Tobacco Manufacturers of America and Commonwealth Brands, Inc. ("Intervenors") separately moved to intervene. Intervenors are tobacco manufacturers and distributors that are not parties to, or beneficiaries of, the Settlement Agreement. Intervenors alleged that the HIF could not be enforced against them if the district court invalidated the HIF as to the Settling Defendants and their distributors.

The State asserted that the HIF is a valid legislative exaction not prohibited by the Settlement Agreement and, consequently, that requiring Defendants' Distributors to pay the HIF does not violate the Agreement. The State further argued that, even if the district court prohibited enforcement of the HIF against Defendants' Distributors, continued enforcement against Intervenors would not violate equal protection principles.

In an Order dated December 20, 2005, the district court, the Honorable Michael F. Fetsch presiding, held that imposing the HIF on Defendants' Distributors breached the Settlement Agreement and violated the Contracts Clauses of the state and federal constitutions. App. at 14, 16. The court then concluded that imposing the

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this case is retained [in the Ramsey Count District Court] for the purpose of enforcement. . . ." *See* App. at 80.

HIF on Intervenors alone would deprive them "of equal protection under the Uniform Taxation Clause of the Minnesota Constitution," and "would be the functional equivalent of a special legislation" favoring Defendants. *Id.* 16-18. The district court subsequently stayed enforcement of its Order pending resolution of this appeal. *See id.* at 20-21.

STATEMENT OF FACTS

A. The Minnesota Tobacco Litigation and Settlement

On August 17, 1994, the State, through then-Attorney General Hubert H. Humphrey III, commenced suit (the "State Tobacco Lawsuit") against Defendants and others. The State alleged, among other things, that Defendants, through deceit, misrepresentation and active concealment, profited from a product they knew to be deadly and addictive even as they marketed it to children. *See generally* Defs.' Mem. Supp. Mot. Enforcmnt. Settlmt. Agrmt. ("Defs.' Mem."), Affidavit of Edward B. Magarian ("Magarian Aff."), Ex. B., (State Tobacco Lawsuit, Second Amended Complaint dated Jan. 6, 1998).

The State asserted nine causes of action against Defendants, including both common law claims (e.g., unjust enrichment) and statutory claims (e.g., consumer fraud, false advertising, unlawful and deceptive trade practices and antitrust). *Id.* at 30-37. The State sought an award of substantial compensatory, punitive and treble damages, civil penalties, and equitable and injunctive relief. *Id.* at 37-40.

In May 1998, after a lengthy trial, but before the jury returned a verdict in the State Tobacco Lawsuit, the State

and Defendants entered into the Settlement Agreement and jointly obtained entry of a Consent Judgment (together, the "Agreement"). The Agreement lies at the center of the current dispute between the parties.

The parties entered the Agreement to resolve the legal claims made by Minnesota: "to settle and resolve with finality all claims . . . relating to the subject matter of this action which have been or could have been asserted by the State of Minnesota." App. at 37; *see id.* at 50-52 (State's release of claims). Defendants likewise released all of their "claims" against the State, *see id.* at 52-53, and they agreed to make specified payments in exchange for the "dismissal and release of claims by the State of Minnesota." *Id.* at 39. The term "claims" is defined in relevant part as follows:

> [T]he State of Minnesota shall release and forever discharge all Defendants and their. . . distributors . . . from any and all manner of *civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees*, known or unknown, suspected or unsuspected, accrued or unaccrued, *whether legal, equitable or statutory* ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:

> for past conduct, as to any Claims relating to the subject matter of this action . . . ; and
>
> for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

App. at 50-51 (emphasis added).

As part of its release, the State covenanted and agreed that it would not "hereafter sue or seek to establish civil liability against any person or entity covered by the release . . . based, in whole or in part, upon any of the Released Claims." App. at 52. The State further agreed that "this covenant and agreement shall be a complete defense to any such *civil action or proceeding*." *Id.* (emphasis added).

Attorney General Humphrey was the sole elected state official to sign the Agreement. App.. at 20. The Agreement was never presented to or ratified by the Legislature.

The Settlement Agreement and an accompanying Consent Judgment were submitted by the parties to the Court, and the Honorable Kenneth J. Fitzpatrick approved and entered the Consent Judgment. *See* App. at 72-82. The Consent Judgment resolved "all claims set forth in the State's Second Amended Complaint against Defendants, which are hereby dismissed with prejudice, and shall constitute the final disposition of this action." *Id.* at 80.

B. The Minnesota Cigarette Excise Tax

When Minnesota's Settlement Agreement was negotiated and executed, the State imposed an excise tax of 48 cents per pack upon the sale of cigarettes. *See* Minn. Stat. § 297F.05, subd. 1 (Supp. 1997).[3] The State has continued to collect from distributors, without objection, the excise tax for cigarettes manufactured by the Settling Defendants.

C. The Minnesota Health Impact Fee

On July 14, 2005, Governor Pawlenty signed into law a Tobacco Health Impact Fee effective August 1, 2005. *See* Act of July 14, 2005, ch. 4, art. 4, §§ 1-6, 2005 Minn. Laws (1st Sp. Sess.) 2541-44 (the "Act") (App. at 33-36). The Act was introduced during a special legislative session and produced the political compromise that enabled Minnesota to balance its budget.[4] The Act declares that "[a] tobacco use health impact fee is imposed on and collected from cigarette distributors," and it specifies two purposes: "to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by

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[3] Minnesota began taxing the sale of cigarettes in 1947. *See* Act of April 28, 1947, ch. 619, §§ 1-2, 1947 Minn. Laws 1122-24 (codified as amended at Minn. Stat. § 297.01-02 (1949)).

[4] *See, e.g.*, Bill Salisbury, *Pawlenty Battered, Unbowed at Capitol*, St. Paul Pioneer Press, July 17, 2005, at 1A ("The tobacco charge, Pawlenty said this week, is what it took to broker the deal that ended the partisan dogfight at the Capitol and pass a balanced budget that provides a big infusion of new cash for K-12 schools.").

youths." Act § 2, subd. 1. The HIF was imposed at the rate of 75 cents per pack. *Id.* § 2, subd. 3(a).[5]

The HIF is administered by the Commissioner of Revenue ("Commissioner"), who also administers the State's cigarette excise tax imposed by Minn. Stat. § 297F.05. Indeed, the Act provides that "[a] distributor must pay the fee at the same time and in the same manner as provided for payment of [the cigarette excise] tax under chapter 297F." *Id.* at § 2, subd. 4. Failure to pay either of these exactions can lead to the revocation of a distributor's license.[6] *See id.* § 2, subd. 8; Minn. Stat. § 297F.04, subd. 1 (2004).

The Act also "created in the state treasury a health impact fund to which must be credited all revenue from the health impact fee." Act § 1, subd. 1; *see also id.* § 2, subd. 9 (directing that fee revenue be credited to fund). The Act requires the Commissioner of Human Services to certify to the Commissioner of Finance each year "the state share, by fund, of tobacco use attributable costs for the previous fiscal year in Minnesota health care programs, including medical assistance, general assistance medical care, and MinnesotaCare, or other applicable expenditures." *Id.* § 1, subd. 2. The Commissioner of Finance must then transfer "to the general fund an amount sufficient to offset the general fund cost of the

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[5] The Act also imposed a floor stocks fee at the same rate to account for cigarettes already in stock or on the shelves. Act § 5, subd. 2.

[6] By selling cigarette stamps for $1.485 each, the Commissioner actually collects three charges at once: (a) the 75-cent HIF; (b) the 48-cent cigarette excise tax; and (c) the State's 25.5-cent cigarette sales tax.

certified expenditures . . . or the balance of the fund, whichever is less." *Id.* §1, subd. 3(a). If a balance remains, the Finance Commissioner must then transfer "to the health care access fund the amount sufficient to offset the health care access fund cost of the certified expenditures." *Id.* § 1, subd. 3(b).

D. Motion to Enforce Settlement Agreement

On August 26, 2005, Defendants moved to enforce the Agreement. Defendants noted that the Agreement released Defendants and their distributors from any "claims" to recover State healthcare costs attributable to tobacco use, and they asserted that the HIF qualifies as a released "claim." Defendants argued that imposing the HIF on their distributors therefore breached the Agreement and violated the Contracts Clauses of the United States and Minnesota Constitutions. Intervenors asserted that if the district court invalidated the HIF as to Defendants and their distributors, continued enforcement of the HIF against Intervenors would violate equal protection.

The State responded that the HIF is a legislative exaction rather than a released "claim" under the Agreement and, consequently, that the Agreement does not bar collection of the HIF from Defendants' Distributors. The State also argued that the Agreement incorporates the Minnesota Constitution's express prohibition against contracting away the State's taxing power, and therefore cannot bar collection of the HIF, which is in substance a tax upon the distribution and sale of cigarettes. Finally, the State argued that, even if the district court prohibited enforcement of the HIF against Defendants' Distributors,

continued enforcement against Intervenors would not violate equal protection.

By Order dated December 20, 2005, the district court enjoined the Commissioner from enforcing the HIF against both Defendants' Distributors and Intervenors. App. at 9. The court rejected the State's argument that the Agreement's release of "claims" did not apply to legislative exactions. The court reasoned that this "reading of the release, which would limit its operating effect only to 'judicial claims,' ignores definition [sic] of claims within the settlement agreement, which is much broader, and includes '. . . liabilities of any nature whatsoever' including those of a 'statutory' nature." *Id.* at 14. The court found that "[t]he H.I.F. is statutory in nature and directly imposes that from which the defendants are protected by the Settlement Agreement." *Id.* The court further concluded that the HIF is a "fee" rather than a tax, and that it violates the State's release. *Id.* at 13.

The court further determined that "defendants have proven a 'contracts clause' violation." App. at 16. "Here the state seeks to abrogate that which what [sic] it has promised but offers neither to forego future payments or to refund past payments." *Id.* The court considered it "impossible to find that the [HIF] legislation is a reasonable device which serves the end of protecting the vital interests of the community." *Id.* For these reasons, the court enjoined the Commissioner from enforcing the HIF against Defendants' Distributors.

The court next concluded that "[t]he resultant situation creates an anomoly [sic] in the marketplace by which the settling defendants' products will have a distinct marketplace advantage in price." App. at 16-17.

> In light of my decision above, the H.I.F., as applied to the distributors of nonsettling defendants, who comprise approximately ten percent of the market, will be selectively enforced only as to the remaining ten percent. None of the statute's stated statutory goals will be fulfilled. The nonsettling defendants will be singled out and deprived of equal protection under the Uniform Taxation Clause of the Minnesota Constitution.

App. at 17. The court thus enjoined the Commissioner from enforcing the HIF against Intervenors. *Id.* at 9. The court subsequently stayed enforcement of its Order pending resolution of this appeal. *See id.* at 20-21.

STANDARD OF REVIEW

Because the facts in this case are undisputed, "only questions of statutory and contract interpretation remain." *Progressive Specialty Ins. Co. v. Widness ex rel. Widness*, 635 N.W.2d 516, 518 (Minn. 2001). These are legal issues subject to *de novo* review. *Id.*; *Lake Superior Paper Industries v. State*, 624 N.W.2d 254, 258 (Minn. 2001). *Cf. also Nelson v. Am. Family Ins. Group*, 651 N.W.2d 499, 503 (Minn. 2002) (holding that where district court grants summary judgment based on application of statute to undisputed facts, result is legal conclusion that appellate court reviews *de novo*). The decisional standards governing particular issues are discussed below.

SUMMARY OF ARGUMENT

This case involves an attempt by tobacco manufacturers to advance an implausible construction of an agreement settling litigation claims to block the valid exercise of the Legislature's sovereign police and taxing powers.

Imposing the HIF upon Defendants' Distributors does not violate the 1998 Settlement Agreement. The Agreement is a mutual release of adjudicatory claims only. The State promised that it would never "sue or seek to establish civil liability against any person . . . based, in whole or in part, upon any of the Released Claims." App. at 52. The language and context of the Agreement demonstrate that it does not surrender the Legislature's sovereign power to impose a tax or fee upon the distribution of cigarettes.

Moreover, even if there were some question about whether the term "claims" in the Agreement encompasses legislative exactions, any doubt over the construction of the Agreement must be resolved in the State's favor. Courts have long held that government contracts must be strictly construed against the surrender of the State's sovereign police and taxing powers. In fact, under the "unmistakability doctrine," any contractual relinquishment of these powers must be stated "in language and terms too clear to admit of doubt." For these reasons – regardless of whether it is a tax or a fee – the HIF is a legislative exaction rather than a released "claim" under the Agreement. Therefore, imposing the HIF does not breach or impair the Agreement.

In the alternative, the Minnesota Constitution provides that "[t]he power of taxation shall never be surrendered, suspended or contracted away." Minn. Const. art. X, § 1. Consequently, the Agreement could not, as a matter of

law, contract away the State's power to tax the distribution of cigarettes. Despite its label as a "fee," the HIF is really a tax on cigarette distribution. As such, the HIF is not a released "claim" and could not possibly breach or impair the Agreement.

Finally, even if the district court properly enjoined the Commissioner from enforcing the HIF against Defendants' Distributors, it erred by ruling that continued enforcement of the HIF against Intervenors violates equal protection guarantees. Equal protection is not offended when the State enforces a law of general application against all parties over whom it has lawful enforcement authority.

ARGUMENT

I. THE LANGUAGE AND CONTEXT OF THE AGREEMENT DEMONSTRATE THAT THE PARTIES INTENDED IT TO BE A MUTUAL RELEASE OF ADJUDICATORY CLAIMS ONLY.

The HIF is not a released "claim" under the Agreement. The language and context of the Agreement demonstrate that the parties drafted and executed a mutual release of adjudicatory claims only. This construction of the Agreement is further compelled by application of the well-established "unmistakability doctrine" discussed in Argument II below. Accordingly, the State's release of claims in the Agreement does not apply to, or prohibit, future legislative exactions such as the HIF. Because the

district court erred in its cursory analysis of this issue, this Court should reverse.[7]

A. The Settlement Agreement And Consent Judgment Must Be Construed As A Contract.

Consent judgments are entered into by parties after careful negotiations concerning precise terms, and must be "construed for enforcement purposes basically as a contract." *United States v. ITT Cont'l Baking Co.*, 420 U.S. 223, 238 (1975). Accordingly, the Agreement must be interpreted to "give effect to the mutual intention of the parties at the time of contracting." *Carl Bolander & Sons, Inc. v. United Stockyards Corp.*, 215 N.W.2d 473, 476 (Minn. 1974) (internal quotation marks and citation omitted). "[T]he scope of a consent decree must be discerned within its four corners." *United States v. Armour Co.*, 402 U.S. 673, 681 (1971).

The Court's duty is "to declare the meaning of what is written in the instrument." *Carl Bolander & Sons*, 215 N.W.2d at 476. To arrive at that meaning, courts must construe contract terms in the context of the entire document, reading together and harmonizing terms where possible. *See Motorsports Racing Plus, Inc. v. Arctic Cat Sales, Inc.*, 666 N.W.2d 320, 324 (Minn. 2003) ("Intent is ascertained . . . from a process of synthesis in which the words and phrases are given a meaning in accordance

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[7] The Court need not reach the issues addressed in Arguments II, III and IV below if it rules, based on the language and context of the Agreement, that the State's release of "claims" did not surrender legislative authority.

with the obvious purpose of the contract . . . as a whole."). "Where the parties express their intent in unambiguous words, those words are to be given their plain and ordinary meaning." *Id.* at 323.

B. The Language And Context Of The Agreement Demonstrate That The Parties Intended To Release Only Adjudicatory Claims.

The familiar principles of construction set forth above make clear that the "claims" released by Minnesota did not encompass future legislative enactments of taxes or fees, but instead were limited to adjudicatory claims.

1. The Purpose of the Agreement was to Resolve Particular Adjudicatory Claims.

The purpose of the Agreement was to resolve the particular legal claims made by Minnesota in its underlying lawsuit. The Settlement Agreement states, for example, that it "resolve[s] with finality all *claims . . . relating to the subject matter of this action* which have been or could have been asserted by the State of Minnesota." App. at 37 (emphasis added).[8] Defendants agreed to make specified payments in exchange for the "dismissal and release of *claims* by the State of Minnesota." *Id.* at 39 (emphasis added). The Consent Judgment likewise recites that it "resolves all *claims* set forth in the State's Second

[8] *See also* App. at 50 (stating that Settlement Agreement "resolves all *claims* between State and Defendants" and that upon approval by Court, final judgment shall enter "dismissing with prejudice all *claims* as to all Defendants") (emphasis added).

Amended Complaint . . . and shall constitute the final disposition of this action." *Id.* at 80 (emphasis added). The purpose of the Settlement Agreement and Consent Judgment – resolving an active lawsuit involving specific pending legal claims – demonstrates that the released "claims" were likewise legal claims.

2. The Parties' Definition of "Claims" Refers to Adjudicatory Claims.

The parties' definition of "claims" clearly refers to adjudicatory claims. The Agreement defines "claims" in the State's release as "any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ('Claims'). . . ." App. at 50-51. By means of almost identical language contained in a separate provision, Defendants released their "claims" against the State. *See id.* at 52-53. The Agreement is thus, in part, a mutual release of claims.

The adjudicatory context is apparent when the language of the Agreement's release provisions is read to harmonize rather than fragment their words and phrases. The term "claims" used in both provisions captures three general categories. The opening group of terms in the definition – "civil claims, demands, actions, suits and causes of action" – are all variants of adjudicatory proceedings and the causes of action asserted therein. The next group – "damages whenever incurred, liabilities of any nature whatsoever, including civil penalties" – and expenses

that can result from the adjudication of claims. The final group – "costs, expenses and attorneys' fees" – are expenses associated with pursuing judicial claims. In drafting their settlement agreement, the parties used the term "claims" in its ordinary sense, to refer to lawsuits and the liabilities and costs incident to such suits, whether the basis of the suits was "legal, equitable or statutory."

This typical meaning is confirmed by the covenant in the State's release, which refers exclusively to the adjudicatory context:

> The State of Minnesota hereby covenants and agrees that it shall not hereafter *sue or seek to establish civil liability* against any person or entity covered by the release . . . based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agrees that this covenant and agreement shall be a complete defense *to any such civil action or proceeding*.

App. at 52 (emphasis added). The parties did not, as Defendants assert, use the term "claims" in a strained and unnatural way, to encompass legislative acts.[9]

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[9] The terms "claim" and "cause of action" are virtually synonymous and both pertain to the adjudicatory context. *Black's Law Dictionary*, for example, defines "claim" in relevant part as follows:

> 1. The aggregate of operative facts giving rise to a right enforceable by a court. . . . 2. The assertion of an existing right; any right to payment or to an equitable remedy, even if contingent or provisional. . . . 3. A demand for money, property, or a legal remedy to which one asserts a right; esp., the part of a complaint in a civil action specifying what relief the plaintiff asks for. . . . 4. An interest or remedy recognized at law; the means by which a person can obtain a privilege, possession or enjoyment of a right or thing; cause of action. . . .

(Continued on following page)

3. When the Parties Referred to Future Legislative Action in the Agreement, They Expressly Used the Term "Legislation."

Defendants are highly sophisticated entities that have for decades been subject to a myriad of state and federal legislative regulation and taxation. Had the parties actually intended the State's release to surrender the Minnesota Legislature's sovereign authority to impose either a regulatory fee or a tax upon the distribution of cigarettes, they would have used suitable language to indicate this intention. Indeed, the parties consistently used the word "legislation" in the Agreement to identify future action by either Congress or the Minnesota Legislature, and they referred to these legislative assemblies by name. The parties specified, for example:

- How "[t]he enactment of federal tobacco-related *legislation*" will affect the Agreement. *See generally* App. at 48.
- That Defendants shall not "[s]upport in *Congress* or any forum, *legislation*, rules or policies which would preempt, override, or abrogate or diminish the State's rights or recoveries under this Agreement." *Id.* at 54.
- That Defendants shall not "[o]ppose the passage of those *future Minnesota legislative proposals* or administrative rules intended by their terms to

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Black's Law Dictionary 264 (8th ed. 2004). *See also Hauschildt v. Beckingham*, 686 N.W.2d 829, 840 (Minn. 2004) (stating that "claim" and "cause of action" "can be used interchangeably"); *Martin ex rel. Hoff v. City of Rochester*, 642 N.W.2d 1, 9 (Minn. 2002) (stating that a claim or cause of action is "a group of operative facts giving rise to one or more bases for suing").

reduce tobacco use by children listed on Schedule B. (The foregoing does not prohibit Settling Defendants from resisting enforcement of, or suing for declaratory or injunctive relief with respect to any such *legislation* or rule on any grounds.)" *Id.*

- That "the parties recognize that *Congress* is considering *national tobacco legislation* and have agreed to settle this case on a basis which acknowledges *possible federal legislation*, but which guarantees to the people of Minnesota the relief granted herein." *Id.* at 69.

Had the parties intended a surrender of State legislative powers in addition to the legal claims identified in the State's release, they would have made their intention plain by using the term "legislation" as they frequently did elsewhere in the Agreement. The terms "claims" and "legislation" are distinct, have different meanings, and cannot be used interchangeably. *See, e.g.*, *Winthrop Res. Corp. v. Stanley Works*, 259 F.3d 901, 905 (8th Cir. 2001) (refusing to equate two separate contract terms and holding that distinct terms have separate meanings); *Sultan Chemists, Inc. v. EPA*, 281 F.3d 73, 79-80 (3d Cir. 2002) (same).

C. The District Court Improperly Expanded The State's Release By Ruling That It Applied To – And Prohibited – Legislative Enactments.

The district court reasoned that the State's release encompasses legislative impositions merely because it includes the phrase: "liabilities of any nature whatsoever." App. at 14. This ruling is incorrect for several reasons. First, some broad mention of "all liabilities" is boilerplate

language routinely used in release-of-claims provisions resolving adjudicatory disputes. *See, e.g., Minnesota Def. Lawyers Ass'n Release Deskbook*, App. of Forms at F-1 (Eric J. Magnuson & Stephen O. Plunkett eds. 1998). For example, the model version of a "Full and Final Release of All Claims" states:

> IN CONSIDERATION of the payment of . . . , I/we do hereby release and forever discharge [DEFENDANT] . . . from *any and all liability*, actions, causes of action, claims and demands, known and unknown, upon and by reason of any damage, loss or injury which heretofore have been or which hereafter may be sustained by me. . . .

Id. (emphasis added). In the settlement context, "liability" is a subset of judicial "claims."[10] It is unreasonable to attribute a broader meaning to that term here simply because one of the parties is a government entity. Indeed, nothing indicates that the term "liabilities" in this *particular* release was intended to encompass future state legislative enactments. Rather, the only reasonable conclusion is that the parties used boilerplate – customary language – for its customary purpose. If this Court were to adopt the

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[10] *See id.* at F-11 ("The term 'claims or causes of action' includes, but is not limited to, *all liability*, actions, causes of action, claims and demands. . . .") (emphasis added); F-48 ("Employee hereby . . . releases . . . Company from any and all federal, state or local charges, claims, controversies, causes of action, damages, costs, attorneys' fees, *or liabilities of any nature. . . .*") (emphasis added); and F-65 ("ABC Corporation . . . and the Settling Defendants . . . do hereby release . . . each other . . . from and for any and all existing or potential demands, causes of action, equitable or legal claims, obligations, damages, losses, penalties *and liabilities of any nature whatsoever. . . .*") (emphasis added).

district court's reasoning, every State settlement agreement that includes a boilerplate release referring to "all liabilities" would actually work a broad surrender of legislative power. This result is both unreasonable and contrary to well established precedent. *See infra*, Arg. § II (discussing unmistakability doctrine).

Second, the phrase "liabilities of any nature whatsoever" appears in the Defendants' release as well as the State's. *See* App. at 52-53. Plainly, however, Defendants had no legislative authority to surrender. Courts disfavor reading the same term to mean different things in different parts of a contract. *See, e.g., Thompson v. Amoco Oil Co.*, 903 F.2d 1118, 1121 (7th Cir. 1990) ("Unless a contrary intent is evident, words used in one sense in one part of a contract are deemed of like significance in another part.").

Third, the district court erred by concluding that the HIF is a released "statutory claim" under the Agreement. *See* App. at 14. Both release provisions in the Agreement – the State's and the Defendants' – surrender claims "whether legal, equitable, or statutory." The term "statutory claims" refers to legal causes of action provided by statute rather than common law. The State, for example, asserted several "statutory claims" in the State Tobacco Lawsuit, including consumer fraud, false advertising and antitrust. *See* Defs.' Mem., Magarian Aff., Ex. B. at 31-36. Nothing in the context or language of the Agreement suggests that "statutory claims" encompasses future legislative enactments of self-executing fees or taxes, particularly where this same meaning cannot be applied to the same language in Defendants' release.

In negotiating the Agreement, the parties used common and well defined legal terms. When interpreting the

Agreement, the Court should give such terms their common meaning and find that "claims" refers exclusively to adjudicatory claims or causes of action that Minnesota agreed never again to pursue. The Court should not broaden these terms to cover future legislative acts.

D. Because The Agreement Does Not Surrender The Legislature's Power To Impose An Exaction On The Distribution Of Cigarettes, Imposing The HIF Does Not Breach Or Impair The Agreement.

The district court ruled that imposing the HIF on Defendants' Distributors breaches and impairs the Agreement. App. at 14, 16. Because the State did not convey away its sovereign authority to impose legislative exactions upon the distribution of cigarettes, these legal conclusions were erroneous.

Breach of contract occurs when a party totally or partially fails to perform its obligations under a contract. *See, e.g., Associated Cinemas of Am. v. World Amusement Co.*, 276 N.W. 7, 10 (Minn. 1937). Impairment of contract in violation of the federal and state contracts clauses[11] occurs when a state law substantially disrupts a party's reasonable contractual expectations. *Jacobsen v. Anheuser-Busch, Inc.*, 392 N.W.2d 868, 872 (Minn. 1986). Impairment occurs, that is, where legislation "alters the terms of a contract by effectively imposing on one of the parties an obligation which it had not reasonably

[11] U.S. Const. art. I, § 10 states: "No state shall . . . pass any . . . law impairing the obligation of Contracts." Minn. Const. art. I, § 11 states: "No . . . law impairing the obligation of contracts shall be passed."

anticipated or relieving a party of a contractual obligation." *Bannum, Inc. v. Town of Ashland*, 922 F.2d 197, 202 (4th Cir. 1990) (citing *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-46 & n.16 (1978)).

The district court ruled that enforcing the HIF against Defendants' Distributors breaches the Agreement because it "directly imposes that from which the defendants are protected." App. at 14. The court likewise found impairment of the Agreement concluding that "the state seeks to abrogate that which what [sic] it has promised but offers neither to forego future payments or to refund past payments." *Id.* at 16. This, however, is just another way of saying that imposition of the HIF breaches the State's release.

As discussed above, imposition of the HIF does not breach the Agreement. Consequently, it also does not impair the Agreement. Although the State promised it would never again sue Defendants to recover State healthcare costs, it never promised Defendants that their products would be immune to future legislative impositions.

II. THE TERM "CLAIM" CANNOT BE INTERPRETED TO INCLUDE LEGISLATIVE EXACTIONS BECAUSE THE STATE'S RELEASE OF CLAIMS DOES NOT SURRENDER THE STATE'S SOVEREIGN POLICE AND TAXING POWERS "IN LANGUAGE AND TERMS TOO CLEAR TO ADMIT OF DOUBT."

Even if there were some question about whether the term "claims" encompasses legislative exactions like the HIF, any doubt must be resolved in the State's favor. As a sovereign, the State possesses both the police and taxing powers. Courts have long disfavored construing government

contracts as relinquishing a state's sovereign powers. Courts thus hold that any such relinquishment must be stated "in language and terms too clear to admit of doubt." *State v. Great N. Ry.*, 119 N.W. 202, 205 (Minn. 1909), *aff'd*, *Great N. Ry. v. State*, 216 U.S. 206 (1910). The district court erred by failing to apply this well-established principle when construing the Agreement.

A. The Unmistakability Doctrine Requires That Government Contracts Be Strictly Construed Against The Surrender of Sovereign Powers.

The canon of construction requiring that government contracts be strictly construed against the relinquishment of sovereign powers is known as the "unmistakability doctrine." As formulated by the United States Supreme Court, "sovereign power . . . governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." *United States v. Winstar Corp.*, 518 U.S. 839, 872 (1996) (plurality opinion) (ellipsis in original) (internal quotation marks omitted) (quoting *Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 52 (1986)). The doctrine recognizes that the sovereign power of a state can be limited by the Contracts Clause of the United States Constitution, but that any such limitation is potentially problematic. *Id.* at 873-74. "Although [the Contracts] Clause made it possible *for state legislatures* to bind their successors by entering into contracts, it soon became apparent that such contracts could become a threat to the sovereign responsibilities of state governments." *Id.* at 874 (emphasis added).

The unmistakability doctrine was developed by courts "to protect state regulatory powers." *Id.* As explained in *Winstar*:

> Under this rule that all public grants are strictly construed, we have insisted that nothing can be taken against the State by presumption or inference, and that neither the right of taxation, nor any other power of sovereignty, will be held . . . to have been surrendered, unless such surrender has been expressed in terms too plain to be mistaken.

Id. at 874-75 (ellipsis in original) (internal quotation marks and citations omitted). In addition to stating the doctrine's affirmative requirements, *Winstar* also described its negative implications:

> a contract with a sovereign government will not be read to include an unstated term exempting the other contracting party from the application of a subsequent sovereign act (including an Act of Congress), nor will an ambiguous term of a grant or contract be construed as a conveyance or surrender of sovereign power.

Id. at 878. The Court explained that application of the doctrine "turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power of the Government." *Id.* at 879.

This Court has likewise applied the unmistakability doctrine to resist construing contracts as abrogating the State's sovereign power. Before an amendment to the Minnesota Constitution in 1906, for example, it was settled law that the State "may, by contract, irrevocably bind itself not to exercise, or may irrevocably limit the exercise of, its power of taxation." *State ex rel. Hahn v.*

Young, 9 N.W. 737, 747 (Minn. 1881). Despite the State's clear *authority* to abrogate its own power of taxation, the Court nevertheless resisted finding that this authority had been exercised.

> The right of a state government . . . by contract to limit its power of taxation, is a doctrine too firmly established to admit of discussion at this time . . . The contract to be irrepealable, however, must clearly and conclusively appear. The power of taxation is a sovereign prerogative; its exercise is indispensable to the maintenance of the state and its institutions, and no inferences or presumptions arising from indefinite and uncertain language that it has relinquished, limited, or abandoned the right as to any particular person or corporation should be indulged by the court in support of an immunity not enjoyed by all taxpayers alike. *Therefore the contract is strictly to be construed, and must be in language and terms too clear to admit of doubt.*

Great N. Ry., 119 N.W. at 205 (emphasis added). Thus, even when the Minnesota Constitution *permitted* surrender of the taxing power, this Court resisted construing contracts to effect that purpose. All ambiguity was resolved in favor of reserving the State's sovereign power. *Id.; see also Minneapolis Gas Co. v. Zimmerman*, 91 N.W.2d 642, 656 (Minn. 1958) ("[A]ll contracts made by the state are entered into subject to the implied condition that they are ever subordinate to a reasonable and proper exercise of the state's inalienable police power.").

B. The Agreement Does Not Surrender The Legislature's Police And Taxing Powers "In Language And Terms Too Clear To Admit Of Doubt."

The unmistakability doctrine defeats Defendants' claim that the Agreement surrenders the State's police and taxing powers and bars enforcement of the HIF. For such a bar plainly "would block the exercise of a sovereign power of the [State]." *Winstar*, 518 U.S. at 879. First, it would abridge the Legislature's power to impose a fee or tax on the distribution of cigarettes by limiting the exaction to only some cigarettes. Second, as the district court's Order makes clear, it would prevent the Commissioner from enforcing existing law. The doctrine was developed to avoid precisely such results.[12]

The district court's construction of the Agreement does not satisfy the strict requirements of the unmistakability doctrine. The State's release-of-claims provision does not even *mention* the State's taxing or police powers. *Cf. Winstar*, 518 U.S. at 877-78 (waiver of sovereign power will not be inferred from silence). Moreover, that provision contains no language even equivocally suggesting that the State was – in addition to releasing legal claims – surrendering sovereign authority. Even if the State's release were

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[12] The district court did not apply the unmistakability doctrine to *construe* the State's release – to determine its scope in the first instance. Instead, the court interpreted the release as surrendering sovereign powers *without applying the doctrine*, and then declared that this surrender was unproblematic because "the State has consented to the Settlement Agreement. . . ." *See* App. at 16. This, of course, entirely misses the point. For if the Agreement is properly construed under the doctrine as *not* surrendering sovereign powers, then there is no surrender to which the State could "consent."

ambiguous on this point, it would have to be construed as reserving to the State its sovereign powers. *Id.* at 878 ("nor will an ambiguous term of a grant or contract be construed as a conveyance or surrender of sovereign power"); *Great N. Ry.*, 119 N.W. at 205 (prohibiting "inferences or presumptions" of surrender "arising from indefinite and uncertain language"). Most importantly, the Agreement does not declare that the State is surrendering its police or taxing authority "in language and terms too clear to admit of doubt." *Great N. Ry.*, 119 N.W. at 205; *Winstar*, 518 U.S. at 874-75 (requiring unmistakable clarity).

C. The Construction Required By The Unmistakability Doctrine Is Confirmed By The Parties' Drafting Practice.

In this case, the parties' drafting practice confirms the wisdom of the unmistakability doctrine. When the State surrendered a right *not also relinquished by Defendants*, the parties clearly indicated this difference. Although the Agreement's two release provisions are almost identical, the State's release contains *an additional phrase* releasing Defendants from "civil penalties." *Compare* App. at 14 *with id.* at 16. This difference make sense: having no authority to impose civil penalties, Defendants had no occasion to release the State from such penalties. The additional phrase demonstrates that the parties used unambiguous language to signal when the State was surrendering additional "claims."

Cigarette manufacturers do not possess sovereign police and taxing powers; the State does. Whereas Defendants could have no occasion to surrender such powers, the State could. Yet the State's release contains no extra

language surrendering its sovereign powers. The absence of additional, unambiguous language confirms that the Agreement does not surrender the State's sovereign powers.

D. The Construction Required By The Unmistakability Doctrine Is Also Required By The Constitutional Separation Of Powers, Under Which The Term "Claim" Cannot Be Interpreted To Include Legislative Exactions.

Like any contract, the Agreement "must be deemed to have been executed with reference to settled rules of law governing the subject matter." *Despatch Oven Co. v. Rauenhorst*, 40 N.W.2d 73, 78 (Minn. 1949). The Minnesota Constitution provides: "The powers of government shall be divided into three distinct departments: legislative, executive and judicial. No person or persons belonging to or constituting one of these departments shall exercise any of the powers properly belonging to either of the others . . . ." Minn. Const. art. III, § 1. Attorney General Humphrey would not have violated the Minnesota Constitution and acted *ultra vires* by executing an agreement that surrendered Legislative powers. It is unreasonable to interpret the State's release of "claims" as working such a surrender.

The Attorney General is an officer of the Executive Department. Minn. Const. art. V, § 1. As relevant here, the Attorney General controls state litigation. *See* Minn. Stat. §§ 8.01, 8.31, 8.32; *Slezak v. Ousdigian*, 110 N.W.2d 1, 5 (Minn. 1961) (finding that Attorney General's powers include "extensive common law powers" as well as statutory powers, and noting that "courts will not control the discretionary power of the attorney general in conducting

litigation for the state"); *State ex rel. Schmidt v. Youngquist*, 227 N.W. 891, 892 (Minn. 1929) (declaring that the Attorney General "has charge of the state's litigation and is its legal leader and advisor").

Attorney General Humphrey commenced and controlled the lawsuit against Defendants and entered into the Agreement. As Attorney General, he also had the power to file – or to agree to refrain from filing – *future* lawsuits against the Defendants. *See Slezak*, 110 N.W.2d at 5. Consequently, Attorney General Humphrey had both the prerogative to enter a release of *legal claims* and the authority to ensure its performance.

In contrast, the Attorney General possessed no measure of legislative authority. *See* Minn. Const. art. III, § 1. He did not have authority to promise that the Legislature would refrain from exercising the State's police powers, which this Court has declared "inalienable." *See Zimmerman*, 91 N.W.2d at 656. Nor did he have authority to contract away the Legislature's power to tax. *See* Minn. Const. art. X, § 1; *In re Minnehaha Parkway*, 209 N.W. 939, 940 (Minn. 1926). It is unreasonable to conclude that the Attorney General in executing the Agreement, and the district court in ratifying it, acted *ultra vires* and flouted these postulates of Minnesota law.

The only meaningful promise the Attorney General could make, beside settling the State Tobacco Lawsuit and compromising monetarily, was to agree never again to sue Defendants for any legal claims relating to the subject matter of that litigation. By construing the State's release of "claims" to bar only future suits or attempts to establish civil liability through litigation, the Court enforces the important constitutional separation of powers, protects

proper Legislative prerogative, and gives the Agreement its most natural and rational interpretation.[13]

The unmistakability doctrine and the separation of powers both confirm that the parties executed a release of adjudicatory claims only, and that imposing the HIF on Defendants' Distributors does not breach or impair the Agreement. *See supra*, Arg. § I.D.

III. In The Alternative, The Agreement Does Not Bar Imposition And Enforcement Of The HIF Because The Agreement Incorporates The Minnesota Constitution's Express Prohibition Against Contracting Away The Taxing Power.

The Agreement releases Defendants and their distributors from specified state "claims." It neither surrenders – nor purports to surrender – the State's power to tax the distribution of cigarettes. To the contrary, the Agreement must be interpreted as expressly reserving the State's taxing power. This is an *addition* reason to conclude that the Agreement did not surrender the state's taxing power in particular.

The district court erroneously ruled that the HIF is a "fee." *See* App. at 13-14. The court specifically noted,

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[13] The district court finessed the separation-of-powers issue by declaring that the Legislature "acquiesced" in the Agreement. *See* App. at 7 & n.1, 10, 11. This conclusion unrealistically assumes that the Attorney General acted *ultra vires* and violated the Minnesota Constitution. It also fails to explain how the Legislature could "acquiesce" in the surrender of its "inalienable" police powers. *Cf. Springer v. Philippine Islands*, 277 U.S. 189, 208-09 (1928) (doubting that the theory of legislative acquiescence applies "to matters which go to the power of the Legislature to enact" statutes).

however, that "the Legislature is free to raise revenue by means of a tax, and all parties agree that there would be no basis to override such a tax." *Id.* at 15. Proper analysis reveals that, in substance, the HIF is a tax on the distribution of cigarettes. Because a tax is not a released "claim," the Agreement does not bar enforcement of the HIF.

A. The Agreement Incorporates The Minnesota Constitution's Express Prohibition Against Contracting Away The Taxing Power And Does Not Surrender That Power.

The Minnesota Constitution provides that "[t]he power of taxation shall never be surrendered, suspended or contracted away." Minn. Const. art. X, § 1. This prohibition was added to the Constitution by amendment in 1906 ("1906 Amendment").[14] *See* Act of Dec. 27, 1906, 1907 Minn. Laws ix; *In re Minnehaha Parkway*, 209 N.W. 939, 940 (Minn. 1926). The "broad, all-comprehensive language" of the 1906 Amendment "leaves no doubt that it was intended to prevent any impairment of the taxing power in any manner whatever." *Minnehaha Parkway*, 209 N.W. at 940. Governing rules of contract construction require the Court to read the 1906 Amendment into the Agreement.

Contracting parties are presumed to know of laws that directly affect their rights. *See Albrecht v. Sell*, 110

[14] Before this amendment, the State could, by contract, limit its power to tax. *See, e.g., State ex rel Hahn v. Young*, 9 N.W. 737, 746 (Minn. 1881).

N.W.2d 895, 897 (Minn. 1961). Moreover, they are generally presumed to enter contracts "with reference to the existing rules and principles of law applicable to the subject matter." *Propp v. Johnson*, 300 N.W. 615, 617 (Minn. 1941).

> [T]he rationale for this basic rule is that the parties to the contract would have expressed that which the law expressly provides had they not supposed that it was unnecessary to do so. Thus, the court in construing the existing law as a part of the express contract, is not reading into it provisions which are different from those expressed and intended by the parties; it is merely construing the contract in accordance with their intent.

Globe v. Cent. Sec. Mut. Ins. Co., 260 N.E.2d 860, 862 (Ill. Ct. App. 1970); *see also Denice v. Spotswood I. Quinby, Inc.*, 237 A.2d 4, 7 (Md. 1968). This rationale is particularly appropriate where the State is a contracting party.

Under this rule of construction (the "Existing Law Rule"), "[t]he existing statutes and the settled law of the land at the time a contract is made become part of it and must be read into it except where the contract discloses an intention to depart therefrom." *William Lindeke Land Co. v. Kalman*, 252 N.W. 650, 653 (Minn. 1934). "It is well established that to know the obligations of a contract, [a court] must look to the laws in force at the time of its making." *W. States Util. Co. v. City of Waseca*, 65 N.W.2d 255, 261 (Minn. 1954). This rule applies to constitutional provisions. *See Dennis*, 237 A.2d at 7.[15]

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[15] *See also Sch. Dist. No. One of Pima County v. Hastings*, 472 P.2d 44, 46 (Az. 1970) ("the Constitution and laws of the State are a part of

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Because the 1906 Amendment was in force when the Agreement was executed, the Existing Law Rule requires that the Agreement be read as expressly containing: (a) an enumeration of released "claims," *and* (b) a provision specifying that the State's power of taxation "shall never be surrendered, suspended or contracted away." *See, e.g.*, *Propp*, 300 N.W. at 617 (reading existing trust law into contract for deed). These provisions must then be harmonized "to unite them into a consistent agreement." *Eveleth Taconite Co. v. Minnesota Power & Light Co.*, 221 N.W.2d 157, 160 (Minn. 1974) (citation omitted). When the Agreement is read as a whole to include the 1906 Amendment, it must be construed as reserving to the State its absolute power to tax cigarettes.

The Minnesota Court of Appeals has employed precisely this reasoning. In *Anderson v. State*, 435 N.W.2d 74 (Minn. Ct. App. 1989), plaintiffs alleged that the State was contractually bound to continue providing a statutory tax break that was in force when plaintiffs entered certain contracts to which the State was a party. *Id.* at 75-76. The court acknowledged that plaintiffs "may have known of the existence" of the tax break when they executed the contracts, but concluded that this knowledge did not "create a private contractual right" to continue receiving the tax break. *Id.* at 76-77. This was so because the Existing Law Rule included constitutional as well as statutory provisions:

> Increasing taxation or adding a new tax does not impair the obligation of a contract. It is true that

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every contract"); *Globe*, 260 N.E.2d at 862-63 (Existing Law Rule incorporates into contracts "the constitution, statutes, codes, ordinances and court decisions").

> the [statutory] law, as it existed at the time the contract was made, is a part of the contract, *but so is the law with reference to the state's power of taxation.*

Id. at 77 (emphasis added) (quoting *Wiseman v. Gilloiz*, 96 S.W.2d 459, 463 (Ark. 1936)). The Existing Law Rule incorporates the 1906 Amendment into the Agreement and shows that the Agreement did not contract away the State's power to tax.

B. The HIF Is A Tax Rather Than A Fee Because Its Express Purpose Is To Raise Revenue And Because That Revenue Is Ultimately Transferred To The General Fund To Finance Customary Governmental Functions.

The HIF was labeled a fee rather than a tax in the political realm (though not without dissent).[16] This Court has made clear, however, that the legal character of an exaction turns not on its label, but on its purpose and effect. *See Country Joe, Inc. v. City of Eagan*, 560 N.W.2d 681, 686 (Minn. 1997); *Farmers Ins. Group v. Comm'r of Taxation*, 153 N.W.2d 236, 240 (Minn. 1967). Although there is no bright-line test for differentiating between fees and taxes, well-established judicial standards demonstrate that the HIF is a tax.

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[16] *See, e.g.*, Dan Browning, *The Budget Deal*, Minneapolis Star Tribune, July 13, 2005, at 1A (reporting that Rep. Phil Krinkie, Chairman of the House Taxes Committee, resigned as Chairman of the House Working Group on Taxes "because he disagreed with Pawlenty and the House leadership over their support for the tobacco fee, which he insists should be called a tax").

1. The Purpose And Effect Of An Exaction Determine Whether It Is A Tax Or A Fee.

A fee is imposed under the police power, and is "a charge upon those engaged in [a business] for the support and maintenance of the machinery provided by statute for its regulation." *State v. Hovorka*, 110 N.W. 870, 872 (Minn. 1907). Accordingly, "a license fee may be of sufficient amount to include the expense of issuing the license and the cost of the necessary police surveillance connected with the business or calling licensed." *Village of Minneota v. Martin*, 145 N.W. 383, 384 (Minn. 1914). In addition, the nature of a business "may justify, purely from a police power standpoint, a license fee large enough to operate as a restraint upon the number of persons who might otherwise engage therein." *Ramaley v. City of St. Paul*, 33 N.W.2d 19, 22 (Minn. 1948).

A tax, by contrast, is imposed under the taxing power as a revenue-generating measure. *Country Joe, Inc.*, 560 N.W.2d at 686 (holding that city "charge" was tax because it was a revenue-raising measure); *Farmers Ins. Group*, 153 N.W.2d at 240 ("If revenue is the primary purpose, the imposition is a tax.").[17]

"It is not possible to come up with a single test that will correctly distinguish a tax from a fee in all situations. . . ." *State ex rel. Petrol. Underground Storage Tank Release Comp. Bd. v. Withrow*, 579 N.E.2d 705, 710 (Ohio 1991); *see also Okeson v. City of Seattle*, 78 P.3d 1279, 1285

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[17] *Accord River Falls v. St. Bridget's Catholic Church of River Falls*, 513 N.W.2d 673, 675 (Wis. Ct. App. 1994) ("primary purpose of a tax is to obtain revenue"); *Radio Common Carriers v. State*, 601 N.Y.S.2d 513, 515 (N.Y. Sup. Ct. 1993) (tax is "a levy made for the purpose of raising revenue for a general governmental purpose.").

(Wash. 2003) ("Determining what is a tax or a fee is often quite difficult."). Courts look to the substance of challenged legislative exactions rather than to labels, and try to determine their genuine purpose and effect. *See Ramaley*, 33 N.W.2d at 21 (revenue-raising purpose rendered charge a tax); *Farmers Ins. Group*, 153 N.W.2d at 240 (regulatory purpose rendered charge a fee); *Barron v. City of Minneapolis*, 4 N.W.2d 622, 624 (Minn. 1942) (invalidating license fee after concluding that "[w]hat the city council sought to accomplish, and did accomplish, was the enactment of a revenue measure").[18] "Whether a particular statute is a tax or regulatory licensing statute under the police power can be determined from looking at the whole scope and provisions of the enactment." *People v. Bd. of Managers – New City Condo.*, 474 N.Y.S.2d 376, 381 (N.Y. Sup. Ct. 1984).

When an exaction occupies the middle ground between a tax and a fee, courts tend to "emphasize the revenue's ultimate use, asking whether it provides a general benefit to the public, of a sort often financed by a general tax, or whether it provides more narrow benefits to regulated companies or defrays the agency's costs of regulation." *San Juan Cellular Tele. Co. v. Pub. Serv. Comm'n*, 967 F.2d 683, 685 (1st Cir. 1992); *accord Country Joe, Inc.*, 560 N.W.2d at 686.

This substance-over-labels approach was used in *Ramaley v. City of St. Paul*, 33 N.W.2d 19 (Minn. 1948), in which plaintiff liquor dealers alleged that a local $750

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[18] *Accord President Riverboat Casino-Missouri v. Missouri Gaming Comm'n*, 13 S.W.3d 635, 638 (Mo. 2000) ("[W]hat is labeled a fee may in fact be a tax based on its 'real object, purpose and result.' ").

occupation tax was really just a fee that exceeded a State-imposed $250 limit. *Id.* at 20. This Court noted that the tax ordinance "by its express words purports to impose a tax" and that "[i]ts language indicates a revenue purpose." *Id.* at 21. Moving to substance, the Court found no indication that the ordinance was an "exercise of the police power for the licensing or regulation of the liquor business," *id.*, and noted the following in particular:

- The ordinance "establishes no standards of conduct or character for those engaged" in the liquor business.
- Payment "confers no right or privilege to engage in the liquor traffic, and it neither enlarges nor changes any privilege already possessed."
- Payment "is not a condition precedent to the right to do business."
- Failure to pay "unlike a failure to pay a license fee imposed under the police power, does not make it unlawful to continue in the business. The only consequence of nonpayment is a ten percent penalty."

Id. (citation omitted). The ordinance truly imposed a tax where "the privilege or right to operate could be acquired only by payment of a license fee under an entirely different ordinance." *Id. See also President Riverboat Casino*, 13 S.W.3d at 638 (per-patron "admission fee" paid by casino boats was tax rather than fee where its receipts did not "compensate public officials for particular services" but instead funded "customary governmental expenditures").

2. The HIF Is A Tax Because Its Primary Purpose Is To Raise Revenue To Fund Core Governmental Functions.

A proper focus on substance, as illustrated by *Ramaley*, demonstrates that the HIF is a tax rather than a fee. Although the Act purports to impose a fee, "its language indicates a revenue purpose." *See Ramaley*, 33 N.W.2d at 21. First, the Act's expressly stated purpose is to raise revenue: "to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths." Act § 2, subd. 1. Indeed, the HIF is expected to generate approximately $400 million over the next two fiscal years,[19] enough to warrant the creation in the treasury of a special fund. *See* Act § 1, subd. 1 (creating Health Impact Fund). In fact, at 75 cents per pack, the HIF will generate substantially more revenue than the State's 48-cent per-pack cigarette excise tax. *See* Minn. Stat. § 297F.05, subd. 1.

Second, HIF revenue is transferred each year from the Health Impact Fund to the General Fund to cover *already-existing* state healthcare commitments related to tobacco use. *See* Act § 1, subd. 3(a); *see also id.* subd. 3(b) (providing that any residual in Health Impact Fund must be transferred to State healthcare access fund). Healthcare expenditures by the Department of Human Services constitute over twenty percent of the State's annual

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[19] *See* Minnesota House of Representatives, Fiscal Analysts, *Minnesota General Fund Forecasted Revenues, Fiscal Years 2006 & 2007*, http://www.house.leg.state.mn.us/fiscal/files/067fromt.pdf (forecasting that HIF will raise approximately $401 million during the 2006-07 biennium) (last visited Sept. 15, 2005).

expenditures from the General Fund.[20] The State spends more from the General Fund for healthcare than for any purpose other than K-12 education.[21] Because HIF revenue funds healthcare – a core governmental function – the Act must be considered a revenue-raising measure. *See City of North Little Rock v. Graham*, 647 S.W.2d 452, 453 (Ark. 1983) ("public safety fee" on water bill was really tax because it raised revenue for pre-existing, traditional governmental functions and services rather than funding special services provided to payers).[22]

Third, nothing suggests that the Act is truly an "exercise of the police power for the licensing or regulation of the [cigarette] business." *Ramaley*, 33 N.W.2d at 21. Minnesota has licensed tobacco distributors since 1947. *See* Act of Apr. 28, 1947, ch. 619, § 4, 1947 Minn. Laws 1126-27 (codified as amended at Minn. Stat. § 297.04

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[20] *See* Minnesota Dep't of Human Services, About DHS, *Department Overview*, http://www.dhs.state.mn.us/main/groups/agencywide/documents/pub/DHS_id_000256.hcsp (last visited Sept. 15, 2005).

[21] Minnesota Department of Finance, Minnesota State Budget, *General Fund Piecharts*, http://www.budget.state.mn.us/budget/summary/charts/050816_piecharts.pdf (last visited Sept. 15, 2005).

[22] Although the Act requires HIF revenue to be transferred into the General Fund to pay for healthcare expenses, *see* Act § 1, subd. 3, it was widely reported as a measure intended to fund K-12 education by freeing up otherwise-encumbered General Fund dollars. *See, e.g.*, Bill Salisbury, *Pawlenty Battered, Unbowed at Capitol*, St. Paul Pioneer Press, July 17, 2005, at 1A ("The revenue from Pawlenty's cigarette charge won't go directly to schools, but it will free up money in the general fund for that purpose."); Bob Geiger, *MN Marketing Briefs: June 11, 2005*, Finance & Commerce (Minneapolis, MN), (quoting Governor's press secretary Brian McClung as explaining that Governor offered HIF "in the spirit of finishing this legislative session and to fund K-12 education and welfare"). Because it funds both healthcare and education, the Act actually raises revenue for two core governmental functions.

(1949)). The State's current licensing regime is contained in Chapter 297F. Under the provisions of that chapter, it is unlawful to distribute cigarettes without a license. *See* Minn. Stat. § 297F.03, subd. 1. License applications must be submitted to the Commissioner and "must be accompanied by a fee of $300." *Id.* subds. 2, 5. Obtaining a license is a condition precedent that allows a person "to engage in business as a distributor. . . ." *See id.* subd. 7. The Commissioner enforces this licensing regime. *See* Minn. Stat. § 297F.02, subds. 1-2.

Like the challenged tax in *Ramaley* – and unlike the true regulatory provisions of Chapter 297F:

- The Act establishes no new requirements for obtaining a license.
- Payment of the HIF "confers no right or privilege to engage in the [cigarette] traffic, and it neither enlarges nor changes any privilege already possessed."
- Payment of the HIF "is not a condition precedent to the right to do business."

See Ramaley, 33 N.W.2d at 21. Indeed, just as in *Ramaley*, "the privilege or right to operate could be acquired only by payment of a license fee under an entirely different [statute]." *Id.*[23]

The foregoing analysis under *Ramaley* demonstrates that the HIF is a tax. Consideration of other factors

[23] Failure to pay the HIF can lead to license suspension or revocation. *See* Act, § 2, subd. 8. But since failure to pay the excise tax can also have these consequences, *see* Minn. Stat. § 297F.04, subd. 1, they plainly do not make the HIF a "fee."

confirms this conclusion. Courts, for example, sometimes look to the manner in which a government exaction is collected. *See, e.g., Wetzel County Solid Waste Auth. v. West Virginia Div. of Nat. Res.*, 462 S.E.2d 349, 356 (W.Va. 1995) (court's previous decision declaring fire service "charge" a tax rather than a fee focused on the "method the municipality used to collect" the charge).

Here, the manner in which the State collects the HIF also shows that it is a tax. The HIF is administered by the Commissioner under the very same provisions governing the State's existing cigarette excise tax: "The audit, assessment, interest, appeal, refund, penalty, enforcement, administrative, and collection provisions of chapters 270C [Department of Revenue] and 297F apply to the fee imposed under this section." Act § 2, subd. 6. Moreover, the legal "incidence" of the HIF and the cigarette excise tax are identically stated.[24] Finally, "[a] distributor must pay the fee *at the same time and in the same manner* as provided for payment of tax under chapter 297F." Act § 2, subd. 4 (emphasis added). The shared administration, identical incidence, and contemporaneous payment of the HIF and the cigarette excise tax indicate that the HIF is a tax.[25]

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[24] *Compare* Act § 2, subd. 3(a) *with* Minn. Stat. § 297F.05, subd. 1 (both imposing exactions upon "the sale of cigarettes in this state, upon having cigarettes in possession in this state with intent to sell, upon any person engaged in business as a distributor, and upon the use or storage by consumers").

[25] Utterly in spite of these facts, the district court found that the manner of collection "militate[s] *against* finding [the HIF] is a tax." App. at 13 (emphasis added).

Courts likewise focus on "whether there is a direct relationship between the fee charged and the service received by those who pay the fee, or between the fee charged and the burden produced by the fee payer." *See Okeson*, 78 P.3d at 1286. Here, the HIF is collected from cigarette distributors. *See* Act § 2, subd. 1. Distributors, however, receive no special benefit from the HIF. It neither pays for additional healthcare services provided exclusively to distributors, nor for the costs of regulating their business. Instead, the fee is collected to pay for healthcare, "a general benefit to the public, of a sort often financed by a general tax." *San Juan Cellular Tele.*, 967 F.2d at 685.

The HIF is certainly collected to raise revenue for customary government services *ultimately necessitated by* the business of distributing cigarettes, viz., state healthcare costs associated with smoking. But this revenue-raising purpose simply underscores the conclusion that the HIF is a tax. While the State may charge greater fees to businesses that are more costly to regulate, *e.g.*, those requiring extensive inspections[26] or those that may degenerate into nuisances,[27] fees must still be proportional to the *regulatory burden* imposed by the business. *See, e.g., State v. Labo's Direct Serv.*, 44 N.W.2d 823, 825-27 (Minn. 1950); *City of Mankato v. Fowler*, 20 N.W. 361, 362 (Minn. 1884). The costs recoverable by a fee "must be only the cost of *regulating the business itself* and not the general public, who may also become patrons of the business or who

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[26] *See, e.g., San Juan Cellular Tele.*, 967 F.2d at 686; *Mississippi Power & Light Co. v. United States Nuclear Regulatory Comm'n*, 601 F.2d 223, 225-29 (5th Cir. 1979).

[27] *See Martin*, 145 N.W.2d at 384; *City of Duluth v. Marsh*, 73 N.W. 962, 962 (Minn. 1898).

incidentally benefit by increased safety because of the city's use of police." *State v. N. Raceway Corp.*, 381 N.W.2d 526, 529 (Minn. Ct. App. 1986) (emphasis added). Where a measure raises revenue to pay for core government services – rather than for the costs of regulation – the measure is a tax.[28] The district court completely ignored this principle. *See* App. at 8-10.

The earmarking of revenue, and the segregation of such revenue into a special fund, does *not* magically change the HIF into a fee. *See Okeson*, 78 P.3d at 1286. In *Okeson*, the City of Seattle passed an ordinance "transferring the responsibility to pay for streetlights from Seattle's general budget" to the customers of the city's electric utility. *Id.* at 1282. Rate increases were paid into a "Light Fund," which was separate from Seattle's general fund. Proceeds from the Light Fund were used "to pay for street lighting and streetlight improvements." *Id.* at 1282, 1286. "Except for streetlights, Seattle otherwise continued to pay for its electricity usage." *Id.* at 1282. Ratepayers, among others, challenged the ordinance. *Id.* at 1283-84.

The court held that the ordinance imposed a tax rather than a fee. *Id.* at 1285-87. The court first concluded that providing public streetlights is a governmental function, *id.* at 1284-85, and that the purpose of the ordinance was to raise revenue (indicating that it imposed a tax). *Id.* at 1286. The court then observed that revenue generated by the ordinance was placed into the Light

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[28] The general public clearly perceives the HIF as a tax rather than a fee. *See, e.g.*, Minnesota State Senate, *2005 State Fair Poll* (reporting that 78.5 % of respondents in unscientific survey of 4820 Fair attendees believed HIF is tax), http://www.senate.leg.state.mn.us/departments/secretary/info/statefair/2005/fair_survey.pdf.

Fund and was used for streetlights and improvements. *Id.* At first blush, this "point[ed] to the cost shifting as a regulatory fee, and not a tax." *Id.* But the court emphasized that substance ultimately governs labels:

> Although depositing funds into a special account established for the stated purpose indicates it is a fee, it is important that it serves a regulatory purpose. All funds could be deposited into special accounts, and that would not necessarily turn taxes into fees. If the costs imposed do not regulate the activity, then the increased rates would, by definition, not be allocated for an authorized "regulatory" purpose. They would simply be a clever device by which taxes are guised as fees by virtue of the account in which they are deposited. Because the charges for street lighting serve no regulatory purpose, [the ordinance] cannot impose a fee just by putting those costs into the Light Fund.

Id. Although earmarking revenues and placing them into a special fund can support the finding that a legislative exaction is a fee, *see Country Joe, Inc.*, 560 N.W.2d at 686, a tax does not automatically become a fee merely due to such an arrangement. That determination ultimately turns on genuine purpose and effect of a legislative enactment.

3. Specifically, The HIF Is A Special Excise Tax Upon The Business Of Distributing Cigarettes.

The HIF is a tax because its purpose and effect are to raise revenue for a core governmental function. Although it is sufficient for present purposes to conclude simply that the HIF is a tax, a more precise classification is possible.

Specifically, the HIF is an excise tax that constitutes a "special tax" upon the business of distributing cigarettes.

An excise tax is a revenue-raising measure "imposed directly by the legislature without assessment . . . ." *Pullman Co. v. Comm'r of Taxation*, 25 N.W.2d 838, 848 (Minn. 1947) (Magney, J., dissenting) (quoting 51 Am.Jur., *Taxation*, § 35). An "excise" is "[a] tax imposed on the manufacture, sale, or use of goods (such as a cigarette tax). . . ." *Black's Law Dictionary* 605 (8th ed. 2004). Because the HIF is imposed with – and in precisely the same manner as – the State's cigarette excise tax, the HIF is a tax as well.

The Act's public health and regulatory purposes are entirely consistent with the imposition of an excise tax. Indeed, the familiar term "sin tax" is defined as "[a]n excise tax imposed on goods or activities that are considered harmful or immoral (such as cigarettes, liquor, or gambling). – Also termed *repressive tax*." *Black's Law Dictionary* 1499 (8th ed. 2004). Indeed, the Ninth Circuit Court of Appeals recently recognized that there is "a long history of excise taxation directed at particular industries in the name of public health and welfare." *R.J. Reynolds Tobacco Co. v. Shewry*, 423 F.3d 906, 922 (9th Cir. 2005), *petition for cert. filed*, 74 U.S.L.W. 3407 (U.S. Jan. 6, 2006) (No. 05-867); *see also id.* at 921 ("Nor is it a novel feature of American government to levy an excise tax on a particular industry and then use the proceeds of that tax in ways that regulate that industry.").

The HIF can also be classified as a "special tax," which is: "1. A tax levied for a unique purpose. 2. A tax (such as an inheritance tax) that is levied in addition to a general tax." *Black's Law Dictionary* 1499 (8th ed. 2004).

The term "special tax" embraces an exaction imposed upon particular taxpayers to recover state costs thought to be associated with those taxpayers:

> In some instances the expense of a particular public function is met in whole or in part by a tax on those who will benefit by the maintenance of such function or who may be supposed to have caused the expense to be incurred . . . Moreover, a special tax has been taken to mean an exaction which a taxing power may impose in addition to the general levy, as, for example, road taxes. . . .

71 Am.Jur.2d *State and Local Taxation* § 21 (1973) (citations omitted).

This Court has held, for example, that "[t]he gasoline excise tax was a 'special tax' imposed on the business of dealing in gasoline, with the purpose of raising revenue for maintenance and construction of the Trunk Highway System." *Amoco Corp. v. Comm'r of Revenue*, 658 N.W.2d 859, 872 (Minn. 2003). The HIF is likewise a special tax on the business of distributing cigarettes to raise revenue for state healthcare costs associated with smoking.

The Act's express purpose is to raise revenue that is transferred to the General Fund to finance a customary governmental function – providing healthcare. It has no true regulatory purpose. Consequently, the HIF is a tax rather than a fee. As this Court has said: "When it has been apparent that a city's true motivation was to raise revenue – and not merely to recover the costs of regulation – we have disregarded the fee label attached by a municipality and held that the charge in question was in fact a tax." *Country Joe, Inc.*, 560 N.W.2d at 686.

The Agreement did not contract away the State's power to tax the distribution of cigarettes. Because the HIF is in substance a tax, imposing the HIF on Defendants' Distributors does not breach or impair the Agreement. *See supra*, Arg. § I.D.[29]

IV. EVEN IF THE DISTRICT COURT PROPERLY ENJOINED THE COMMISSIONER FROM ENFORCING THE HIF AGAINST DEFENDANTS' DISTRIBUTORS, IT ERRED BY RULING THAT CONTINUED ENFORCEMENT AGAINST INTERVENORS VIOLATES EQUAL PROTECTION GUARANTEES.

Having enjoined the Commissioner from enforcing the HIF against Defendants' Distributors, the district court determined that if it allowed continued enforcement against Intervenors, they would be "singled out and deprived of equal protection under the Uniform Taxation Clause of the Minnesota Constitution." App. at 17. This "selective enforcement" would be improper because none of the Act's "goals will be fulfilled" and because "what is left [of the Act] are distinctions which are manifestly arbitrary and fanciful." *Id.* The court also concluded that "[r]equiring [Intervenors] to pay the H.I.F. would be the functional equivalent of a special legislation singling out for special privilege the settling defendants and in derogation of the nonsettling defendants under Art. 12, Sec. 1,

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[29] Having erred in finding breach and impairment, the district court further erred by ruling that Defendants and Intervenors are entitled to refunds of amounts paid. *See* App. at 9. Neither Defendants nor Intervenors ever requested this relief. *See* App. at 1-5 (Defendants' motion). Consequently, the issue of possible refunds was not raised, briefed or argued. The district court clearly erred by reaching out to address this issue.

Minnesota Constitution." *Id.* at 17-18. The court thus enjoined the Commissioner from enforcing the HIF against Intervenors. *Id.* at 9. These rulings were error.

A. The Standard Of Review Under Relevant Equal Protection Guarantees Is Highly Deferential.

The Fourteenth Amendment to the United States Constitution provides in part that no state shall "deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend. XIV, § 1. Article I, section 2 of the Minnesota Constitution provides in part that "[n]o member of this State shall be . . . deprived of any of the rights or privileges secured to any citizen thereof, unless by the law of the land or judgment of his peers." Minn. Const. art. I, § 2. The Uniformity Clause of the Minnesota Constitution provides in part that "[t]axes shall be uniform upon the same class of subjects. . . ." Minn. Const. art. X, § 1.

When addressing challenges under these equal protection and uniformity provisions, this Court has held that "the scope of their restrictions on the legislative power to tax and to classify is identical. . . ." *J.L. Shiely Co. v. County of Stearns*, 395 N.W.2d 357, 359 (Minn. 1986). Moreover, if the challenge "involves neither a suspect classification nor a fundamental right, [courts] review the challenge under a rational basis standard." *Kolton v. County of Anoka*, 645 N.W.2d 403, 411 (Minn. 2002); *see also John Hancock Mut. Life Ins. Co. v. Comm'r of Revenue*, 497 N.W.2d 250, 253 (Minn. 1993) ("The proper standard of review of a challenged economic classification is the rational basis test. . . .").

The federal rational basis test requires a court to determine "whether the challenged classification has a legitimate purpose and whether it was reasonable to believe that use of the challenged classification would promote that purpose." *Kolton*, 645 N.W.2d at 411 (citations omitted). The Minnesota rational basis test requires that:

> (1) The distinctions which separate those included within the classification from those excluded must not be manifestly arbitrary or fanciful but must be genuine and substantial, thereby providing a natural and reasonable basis to justify legislation adapted to peculiar conditions and needs; (2) the classification must be genuine or relevant to the purpose of the law; that is there must be an evident connection between the distinctive needs peculiar to the class and the prescribed remedy; and (3) the purpose of the statute must be one that the state can legitimately attempt to achieve.

Id. at 411 (citations omitted).[30]

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[30] The Court uses this same three-factor test to adjudicate challenges brought under the Special Legislation section of the Minnesota Constitution. *See In re Tveten*, 402 N.W.2d 551, 558-59 (Minn. 1987). That section provides in part as follows:

> The legislature shall pass no local or special law . . . granting to any private corporation, association, or individual any special or exclusive privilege, immunity or franchise whatever . . . . The inhibitions of local or special laws in this section shall not prevent the passage of general laws on any of the subjects enumerated.

Minn. Const. art. XII, § 1. By its terms, this provision applies exclusively to the Legislature and to "laws." Intervenors, however, did not challenge the Act *as passed by the Legislature*. For this reason, continued

(Continued on following page)

Judicial review under these rational basis tests is limited to the basic rationality of legislation; it does not extend to questions of "either the factual accuracy or political wisdom of the reasoning and judgments underlying the legislative enactment." *AFSCME Councils 6, 14, 65 & 96 v. Sundquist*, 338 N.W.2d 560, 570 (Minn. 1983). Challenged legislation will be sustained as having a rational basis "if any conceivable state of facts supports it." *Rio Vista Non-Profit Housing Corp. v. County of Ramsey*, 335 N.W.2d 242, 245-46 (Minn. 1983).

Under the rational basis test, "[e]very presumption [is] invoked in favor of the constitutionality of an act of the legislature." *Contos v. Herbst*, 278 N.W.2d 732, 736 (Minn. 1979). Accordingly, "[t]he party challenging the constitutionality of [a] statute bears the burden of establishing 'beyond a reasonable doubt' that the statute violates a constitutional right." *Westling v. County of Mille Lacs*, 581 N.W.2d 815, 819 (Minn. 1998). Although rational basis review is always deferential, "courts are especially deferential in the context of classifications made by complex tax laws." *John Hancock*, 497 N.W.2d at 253 (internal quotation marks and citations omitted).

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enforcement cannot violate the Special Legislation provision. In any event, continued enforcement easily passes the three-part test.

B. Because Continued Enforcement Of The HIF Against Intervenors Satisfies Minnesota's Three-Factor Rational Basis Test, It Comports With State And Federal Equal Protection Principles.

Because the Act satisfies Minnesota's three-factor rational basis test, it comports with equal protection and uniformity principles. First, the State clearly may attempt to achieve the purposes specified by the Act.[31] One goal of the Act is to recover healthcare costs associated with tobacco use. *See* Act § 2, subd. 1. Courts have determined that recovering tobacco-related state healthcare expenses is a legitimate state purpose. *See, e.g., Star Scientific v. Beales*, 278 F.3d 339, 349, 352 (4th Cir.), *cert. denied*, 537 U.S. 818 (2002); *PTI, Inc. v. Philip Morris, Inc.*, 100 F. Supp. 2d 1179, 1207 (C.D. Cal. 2000). The Act's other aim is to deter smoking, particularly by youth. *See* Act § 2, subd. 1. There can be no doubt that deterring underage smoking is a legitimate state interest. *See Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 564 (2001) ("The State's interest in preventing underage tobacco use is substantial, and even compelling. . . .").

Second, the classification resulting in continued enforcement is relevant to the purpose of that enforcement. Because the Act imposes the HIF on the distribution and sale of *all* cigarettes, *see* Act § 2, subd. 3, the Legislature plainly intended to pursue the Act's stated purposes as broadly as possible. Because it granted specific performance, the district court obviously concluded that a

[31] As this Court has done, the State will address the three factors in reverse order. *See Metro. Sports Facilities Comm'n v. County of Hennepin*, 478 N.W.2d 487, 489 n.4 (Minn. 1991).

contractual release prevented the Commissioner from enforcing the HIF against Defendants' Distributors. That ruling plainly prevented the Act's purposes from being accomplished as to distribution and sale of all cigarettes. *See* App. at 17. But the enforcement of a tax of general application against fewer than all taxpayers originally covered by the tax does not violate equal protection principles. *See Cherokee State Bank of St. Paul v. Wallace*, 279 N.W. 410, 413-15 (Minn. 1938) (ruling that general tax subsequently held unenforceable against national banks could still be enforced against state banks).[32]

Here, a judicial determination will have placed certain taxpayers beyond the reach of the Commissioner's enforcement authority. The resulting "classification" distinguishes between those distributors who are beyond the Commissioner's enforcement authority (Defendants' Distributors) and those who remain within that authority (Intervenors). This "classification" is not irrational where the Act continues to pursue its purposes to the greatest extent legally possible.[33]

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[32] *Accord Union Bank & Trust Co. v. Phelps*, 288 U.S. 181 (1933); *see also Hixon v. City of Philadelphia*, 32 Pa. D. & C. 436 (Pa. Ct. Com. Pleas 1938) (court invalidated general tax as to parking lots owned by corporations but held that lots owned by individuals were still subject to tax because resulting classification was reasonable).

[33] *Cf. Kolton*, 645 N.W.2d at 411 ("consistently with the Equal Protection Clause, a State may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind. . . . The legislature may select one phase of one field and apply a remedy there, neglecting the others.") (internal quotation marks omitted) (quoting *Geduldig v. Aiello*, 417 U.S. 484, 494-95 (1974)).

Finally, there is nothing arbitrary about the distinction between taxpayers to whom a law can be applied, and those to whom it cannot. Indeed, this is the very distinction the district court drew. It is obviously genuine (based on a meaningful legal difference) and substantial (based on a legal difference that really matters). Continued enforcement of the Act does not violate equal protection or uniformity principles.

CONCLUSION

For the above stated reasons, the State respectfully requests that this Court reverse the December 20, 2005 decision of the district court in its entirety.

Dated: _____

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CERTIFICATE OF COMPLIANCE
WITH MINN. R. APP. P 132.01, Subd. 3

The undersigned certifies that the Brief submitted herein contains 13,944 words and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedure 132. This Brief was prepared using a proportional spaced font size of 13 pt. The word count is stated in reliance on Microsoft Word 2003, the word processing system used to prepare this Brief.

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No. A05-2540

STATE OF MINNESOTA
IN SUPREME COURT

The State of Minnesota,
by Hubert H. Humphrey III,
its then Attorney General, *et al.*,

Petitioner,

vs.

Philip Morris USA, Inc., *et al.*,
and
A.H. Hermel Candy & Tobacco Co., *et al.*

Respondents.

GOVERNOR TIM PAWLENTY'S AMICUS BRIEF AND APPENDIX

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SUMMARY OF THE ARGUMENT*

Under the Minnesota Constitution, the legislature has the sole power to enact laws to protect the health and welfare of citizens and to regulate business within the state. The Health Impact Fee Act ("HIF Act")[1], 2005 Minn. Laws, 1st Sp. Sass., Ch. 4, Art. 4, §§ 1-6 (A 33-36)[2], is the legislature's most recent exercise of its police powers to regulate cigarette and tobacco products[3] The HIF Act increases the consumer price of cigarettes, thereby reducing smoking, particularly among youths. The HIF portion of the higher consumer price flows to the state thereby requiring tobacco users to offset some of the state's significant health care costs attributable to tobacco use. HIF §2, subd. 1 (A 34).

This appeal raises significant questions regarding the scope of the attorney general's authority in entering agreements to settle the state's litigation. The Tobacco Companies argue that the release language in entering

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* Counsel for governor Tim Pawlenty authored the brief in whole and no other person or entity made a monetary contribution to the preparation or submission of the brief.

[1] References to the HIF Act will be "HIF §___subd.___."

[2] References to the Appellant's Appendix will be "(A ___)."

[3] The Tobacco Defendants, their distributors and the Intervenors are cigarette manufacturers, licensed distributors of cigarettes or their representatives. The Settlement Agreement applies only to cigarettes and smokeless tobacco manufactured by the Tobacco Companies. (A 41-42). It does not apply to other tobacco products, such as cigars, which are within the HIF Act. The district court's order is specific to these parties and, therefore, is specific only to the HIF Act's provisions regarding these products. The Governor's brief will focus on the specific laws relating to the sale of cigarettes in Minnesota. The same arguments apply in relation to other tobacco products.

the 1998 Settlement Agreement grants their distributors the right to be free from future laws related to the state's health costs associated with tobacco products, including the HIF Act. The Intervenors, who have not entered into any contract with the state, assert that they are likewise exempt from state regulation because the Tobacco Companies distributors represent such a large share of the state market.

The Settlement Agreement does not exempt the Tobacco Companies from future taxes, fees or regulation of either cigarettes or tobacco products. Such a broad release is unwarranted by the language of the Settlement Agreement, would usurp the powers of the legislature and violate the separation of powers mandate of the Minnesota Constitution.

The HIF Act is a valid exercise of the state's police powers and serves important public policy interests. The ability of the legislature to enact laws to serve the public interest cannot be contracted away. Any action by the attorney general to impede the legislative powers of the state is *ultra vires* and therefore does not prevent application of the HIF Act to the Tobacco Companies' distributors.

Moreover, even if the Settlement Agreement could be interpreted to "release" the Tobacco Companies' distributors from future state regulation and even if the attorney general had authority to bind the state in such a manner, it is well settled that every contract entered by the state is subordinate to the state's valid exercise of its police powers.

In determining whether a state law unconstitutionally infringes upon a contract right, the courts balance the public interest furthered by the law against the nature of

the impairment. In this case, the HIF Act furthers important public purposes of protecting health and welfare, as well as requiring that tobacco consumers bear financial responsibility for the financial costs to the state stemming from their tobacco use. These important interests are not an unconstitutional impairment of contract.

The Court should reverse the district court's order and uphold the validity of the HIF Act as applied to the Tobacco Companies, their distributors and the Intervenors. If, however, the Court finds an unconstitutional impairment of the Settlement Agreement, the Court should address the issue of an appropriate remedy and fashion a narrow remedy that permits the state to implement as much of the HIF Act as constitutionally permitted.

ARGUMENT

I. THE ATTORNEY GENERAL LACKED AUTHORITY TO CONTRACT AWAY THE LEGISLATIVE POWERS OF THE STATE.

The State's brief argues that the separation of powers doctrine must be read into the Settlement Agreement. In this case, however, the Settlement Agreement itself expressly limits its scope to the actions validly taken by the attorney general. The terms "State" and "State of Minnesota" are expressly defined to include only "the State of Minnesota acting by and through its Attorney General." (A 40). The Agreement does not purport to bind the state in relation to matters that require the state to act through its legislature. Thus, the parties have expressly agreed to bind the state only to the extent the attorney general could validly act on behalf of the state.

This appeal presents issues regarding the scope of the attorney general's authority to enter a settlement agreement that has as a term the "release" of private parties from future laws. If the attorney general lacked the power to enter a contract to bind the state's legislature in such a manner, the definition of "State" in the contract compels a determination that the contract does not contain such a provision. In the alternative, such a provision would be *ultra vires* and unenforceable.

A. The Minnesota Constitution Places the Legislative Powers of the State with the Legislature.

"Government is instituted for the security, benefit and protection of the people, in whom all political power is inherent, together with the right to alter, modify or reform government whenever required by the public good." Minn. Const art. I, § 1. The Minnesota Constitution provides:

> The powers of government shall be divided into three distinct departments: legislative, executive and judicial. No person or persons belonging to or constituting one of these departments shall exercise any of the powers properly belonging to either of the others except in the instances expressly provided in this constitution.

Minn. Const art. III.

The limitations on government officials established by the separation of powers mandate are well-settled.

> The powers and duties of each department are distinctly defined. The departments are independent of each other to the extent, at least, that

> neither can exercise any of the powers of the others not expressly provided for. . . . This not only prevents an assumption by either department of power not properly belonging to it, but also prohibits the imposition, by one, of any duty upon either of the others not within the scope of its jurisdiction; and "it is the duty of each to abstain from and to oppose encroachments on either."

Matter of Application of Senate, 10 Minn. 78, 81 (1865). A constitutional grant of power to one of the three branches of government is a *denial* of that power to the other branches. *Bloom v. Am. Express Co.*, 222 Minn. 249, 256, 23 N.W. 570, 575 (1946).

The Minnesota Constitution vests the state's legislative powers with the legislature. Minn. Const art. IV. Exercise of the state's police powers through the enactment of laws is a legislative function. *State ex rel. Beery v. Houghton*, 164 Minn. 146, 151, 204 N.W. 569, 571 (1925); *State ex rel. Village of Clara City v. Great N. Ry. Co.*, 130 Minn 480, 485, 153 N.W. 879, 880 (1915). The Constitution does not grant the attorney general any legislative power, and he is, therefore, denied such power. *Bloom*, 222 Minn. at 256, 23 N.W. at 575.

The importance of the state's police powers cannot be disputed. In *State ex rel. Pavlic v. Johannes*, 194 Minn. 10, 11-12, 259 N.W. 537, 537 (1935), the Supreme Court described the police powers as:

> That doctrine, too well settled to admit of doubt, is that the police power of a state may be invoked to regulate private enterprise whenever the general welfare of the people is to he furthered or protected, and the legislature has a large discretion to determine not only what the best interests of

> the public require but the manner in which such interest may best be protected.

Even where the constitution expressly grants legislative power to an executive branch official, the Court has been careful to narrowly interpret such power to protect the legislature's constitutional powers. For example, the governor, through his power to sign or veto legislation, is granted limited legislative power under the constitution. Minn. Const. art. IV, § 23. The Court has been careful to interpret the governor's veto authority narrowly "to prevent an unwarranted usurpation by the executive of powers granted the legislature in the first instance." *Inter Faculty Org. v. Carlson*, 478 N.W.2d 192, 194 (Minn. 1991).

The Tobacco Companies assert that the object of the release language was to prevent future legislation. In other words, its express purpose was to limit the legislature's power to enact future laws in this subject area. The release argued by the Tobacco Companies is not grounded in an assertion that enforcement of the HIF Act is a legal claim that was, or could have been, raised by the attorney general in the underlying Tobacco Litigation. Thus, this case does not present a situation where a contract has an unanticipated or incidental conflict with legislation. Rather, the purported contract term is asserted to have as its goal a limitation on future legislative power. The attorney general could not validly make such a promise.

The constitution's denial of legislative power to the attorney general is dispositive. Moreover, an examination of the state's cases relating to the waiver of the state's police powers, and the cases addressing the common law authority of the attorney general confirm this conclusion. The attorney general simply does not have authority to

contract away the legislature's power to determine the current and future legislative policy for the state.

1. The Legislature Did Not, Through its Acts, Grant the Attorney General Authority to Limit Its Future Exercise of Its Police Powers.

The State's brief addresses the well-settled doctrine of unmistakability in relation to any waiver of the state's police powers and those arguments will not be repeated here. Two supplemental points about this doctrine, however, are important.

First, the unmistakability doctrine arguably provides only an initial means for the Court to reject interpretation of a contract in denigration of the state's sovereign powers. In developing the unmistakability doctrine, the Court has questioned the ability of the legislature to waive the police powers even by a clearly expressed intent to do so. *See Grisom v. S. St. Paul Live Stock Exch.*, 152 Minn. 271, 276, 188 N.W. 729, 731 (1922) ("[a]ll contracts relating to matters within the domain of the power are subject to the exercise thereof, for the legislature cannot surrender it or bind the state not to exert it"); *accord State ex rel. St. Paul v. Chicago M & S. P.R. Co.*, 135 Minn. 277, 280, 160 N.W. 773 (1916) ("[t]he police power cannot be surrendered nor divested nor abridged nor bargained away . . . [o]ne legislative body cannot deprive its successor of it"); *State v. Smith*, 58 Minn. 35, 38, 59 N.W. 545, 546 (1894) ("even if it were conceded that the legislature can, by contract or by giving authority to make a contract, bind the state not to exercise the police power, the legislative intent to do so would have to appear unmistakably"). These cases suggest

that the legislature may not even be capable of bargaining away the powers of future legislature to enact laws for the public benefit – even if it had the clear intent to do so.

Second, the question raised by the unmistakeability doctrine is the *legislature's* clear intent to surrender the state's police powers. Nothing permits an executive branch official to bind the legislature's police powers without having been given that clear contract authority by the *legislature.* In this case, there was no such grant of authority by the legislature. The 1998 Settlement Agreement was entered solely by the attorney general exercising the powers of that office to resolve the state's legal claims. The Agreement was not authorized by, negotiated by or ratified by the state legislature.[4]

2. The Attorney General Had No "Common Law" Power to Impair the Legislature's Powers.

The attorney general's common law powers do not vest him with the authority to curtail the legislature's exercise of its legislative power. This Court has recognized that the

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[4] In *Lawyer v. Department of Justice*, 521 U.S. 567 (1997), the United States Supreme Court addressed the validity of a settlement of a redistricting dispute. The court recognized the power of the state's attorney general to represent the state in the proceeding and to propose a plan for settling the dispute. *Id.* at 577. In upholding the proposed redistricting plan, the court recognized that the legislature had participated in the litigation and given approval for the attorney general to offer the plan. *Id.* In addition, the court expressly recognized that the settlement did not prevent the legislature's authority to develop a new plan that differed from the one approved through the settlement. *Id.*

attorney general has *common law powers* to bring and maintain litigation:

> As the chief law officer of the state, the attorney general possesses all of the powers inherent in that office at common law. * * * The attorney general may institute, conduct, and maintain all such actions and proceedings as he deems necessary for the enforcement of the laws of this state, the preservation of order, and the protection of legal right.

Humphrey v. McLaren, 402 N.W.2d 535, 539 (Minn. 1987); *accord Slezak v. Ousdigian*, 110 N.W.2d 1, 5 (Minn. 1961).

The Minnesota courts have not, however, specifically addressed the scope of the attorney general's common law authority to enter contracts settling the state's legal claims. Arguably, the authority of the attorney general to initiate litigation includes the authority to dismiss such actions. In addition, the well-settled doctrine of *res judicata* suggests that the attorney general has the power to accept dismissal of actual claims, or waiver of any claims that could have been raised as part of the litigation.

There is, however, no authority in common law that grants the attorney general the authority to resolve existing litigation by agreeing to "release" a private party from potential future litigation that is based on future conduct, and that could not have been raised in relation to existing claims. Such a broad release of future litigation would unquestionably limit the discretion of future attorneys general to determine the state's legal positions and act in the best interests of the state as the future circumstances dictates. The Minnesota courts have commented on the duty on the legislature to refrain from binding a

future legislature's exercise of its police powers. *See Grisom*, 152 Minn. at 276, 188 N.W. at 731, *State ex rel. St. Paul*, 135 Minn. at 280.

In the instant case, the interpretation of the release language in the Settlement Agreement presents an even more attenuated situation than the release of future adjudicatory claims. Here, the Tobacco Companies assert that the attorney general had authority to promise a private party exemption from future types of regulation by the state. There is no common law basis for this authority.

Permitting the attorney general such unfettered contract authority is contrary to public policy and would permit the power of the chief legal officer to subsume the powers of the entire legislative branch. It would also allow the attorney general, through settlement agreements, to grant exclusive privileges, rights and exemptions to private individuals in a manner that the constitution expressly denies to the legislature. The constitution prohibits the legislature from enacting any special laws that grant private parties any special privilege, immunity, or franchise. Minn. Const. Art. XII, § 1. The legislature could not have passed a law granting the Tobacco Companies distributors' (and not others) exemption from future legislative exactions, license requirements or state laws. The attorney general should not be given authority to grant such special exemptions from current or future laws under the guise of settling the state's legal claims.

B. The Legislature Did Not Ratify the Release Provision of the Agreement.

The legislature did not authorize the Tobacco litigation, did not participate in the settlement negotiations, and the 1998 Agreement was never submitted to the legislature for ratification. The district court dismissed, without analysis, the State and Governor's separation of powers arguments asserting, without any authority, that the legislature "acquiesced" in the release provision limiting its authority when it enacted Minn. Stat. § 297F.24. The district court's analysis should be rejected.

In *Edwards v. Mettler*, 268 Minn. 472, 477-78, 129 N.W.2d 805, 808 (1964) the Court recognized that "[a]cquiescence and waiver are always questions of fact. There can be neither without knowledge. . . . One cannot waive or acquiesce in a wrong while ignorant that it has been committed. * * * There must be knowledge of facts which will enable the party to take effectual action." In relation to the 2003 enactment of Minn. Stat. § 297F.24, there is no evidence in the record that the legislature was aware of the purported *ultra vires* exercise of legislative power by the attorney general, that the legislature could ratify such *ultra vires* acts, or that the Agreement's release provisions could be read to limit future legislative authority. Without specific knowledge of any assertion that the contract included a term that infringed upon legislative authority or that it exceeded the attorney general's authority, there is no basis for asserting that the legislature "acquiesced" in the infringement of its power. Indeed, the legislature's subsequent enactment of the HIF Act reflects that it did not acquiesce in any limitation of its legislative powers.

The "acquiescence" theory also contradicts the express language of the Agreement. The Agreement's limited definition of the "State" as acting through the attorney general creates a right in the state to limit the terms of the agreement to the powers validly conferred upon the attorney general. (A 40). As provided in the Agreement, any waiver of a right conferred by the Agreement must be in writing to be effective. (A 62).

II. Even If The Agreement Released Future Legislative Acts, The State's Valid Exercise Of Its Police Powers Overrides The Contractual Provision.

Assuming for the purposes of argument that the release provision of the Agreement could be interpreted to release the Tobacco Companies from enforcement of future regulatory actions such as the HIF, and assuming that the attorney general had the authority to agree to such a contract provision, the state may still exercise its police powers under appropriate circumstances. "All contracts made by the state are entered into subject to the implied condition that they are ever subordinate to a reasonable and proper exercise of the state's police power."[5] *Minneapolis Gas Co. v. Zimmerman,* 253 Minn. 164, 184, 91 N.W.2d 642, 645 (1958). The full and unfettered exercise of the state's police powers is tempered by the state's obligation to comply with the contracts clauses of the state and federal constitutions. *Christensen v. Minneapolis Municipal*

[5] Because the reserved power of the state to exercise its police powers is part of all contracts entered by the state, the state's valid exercise of this power cannot be a breach of the contract.

Employees Retirement Bd., 331 N.W.2d 740, 749-50 (Minn. 1983).

A. The HIF Act Furthers Important Public Purposes and Is Consistent with the Existing Regulatory Framework for Tobacco Products.

In order to understand the significant public purposes served by the HIF Act, it is important to review the manner in which the Act works in conjunction with other state laws relating to tobacco products and tobacco use.

1. The HIF Act is Intended to Decrease the Health Impacts from Tobacco Use.

In 1985, the legislature made the following findings:

(1) smoking causes premature death, disability, and chronic disease, including cancer and heart disease, and lung disease;

(2) smoking related diseases result in excess medical care costs; and

(3) smoking initiation occurs primarily in adolescence.

The legislature desires to prevent young people from starting to smoke, to encourage and assist smokers to quit, and to promote clean indoor air.

Minn. Stat. § 144.391.

The legislature has enacted numerous laws protecting the health of residents and promoting the reduction of smoking. *See e.g., Minn. Stat.* §§ 144.411 to 144.417 (Clean Indoor Air Act); *Minn. Stat.* § 144.392 to 144.396 (public

health programs to promote health, reduce smoking in youth by 25%, and to assess tobacco related behaviors); *Minn. Stat* § 609.681 (prohibiting unlawful smoking); *Minn. Stat.* § 609.685 (prohibiting tobacco related sale to and use by minors); *Minn. Stat.* § 461.19 (permitting local ordinances regarding smoking and tobacco to be more restrictive than state law).

One of the express purposes of the HIF Act is to reduce tobacco use, particularly among youths. *HIF. § 2, subd. 1 (A 34).* The HIF Act seeks to mitigate the devastating (and expensive) health problems caused by Minnesotans' use of tobacco products by increasing the retail price for a pack of cigarettes by $ 0.75, plus wholesale and retail mark-up. *HIF § 2, subd. 3 (A 34); Minn. Stat.* § 325D.30-325D.33.

In enacting the HIF, the legislators recognized the link between the increased consumer cost of cigarettes and anticipated reductions in smoking. Representative Fran Bradley, Chair of the House Health and Human Services Finance Committee, observed:

> I think that we know clearly that as we increase the cost of tobacco products we see decreases in the number of people who smoke – particularly among young people.

Floor Session of the Minnesota House of Representatives (2005 Special Session – Part 2 of 3) (July 13, 2005) (http://www.house.leg.state.mn.us/htv/1s84/hfsB071305.asx) (1 hr 28 min.)

It was immediately clear that the HIF was effective in its goal of reducing tobacco use and providing an incentive for consumers to quit. One of the local newspapers reported that since August 1, 2005:

> [S]mokers have been turning in droves to the state's quit-smoking hot lines and websites.
>
> Blue Cross and Blue Shield of Minnesota said the number of new enrollees in its stop-smoking program jumped 65 percent . . .
>
> The Minnesota Partnership for Action Against Tobacco said that compared with the first week of August a year ago, calls to its telephone help line more than doubled . . .

Josephine Marcotty, *75 Cents More Per Pack Is A Push To Quit; New Fee Increase Is Driving Many Smokers To Seek Help,* Minneapolis Star Tribune, August 28, 2005, at 1A.

2. Reduction in Use Will Reduce the State's Health Costs.

As expressly found by the legislature, the goal of reducing smoking is integrally tied with the goal of reducing the medical impacts and costs associated with smoking. *See Minn. Stat.* § 144.391. This is especially true if the increased cost prevents young people from starting to use tobacco products. *Id.*

As identified in the HIF Act, the state funds numerous programs that pay for medical care for Minnesotans. *HIF § 1, subd. 2 (A 33).* As a result of continued smoking and tobacco use, the state incurs additional costs to its medical programs as a result of Minnesotans' choice to smoke. These costs are substantial. The HIF Act is anticipated to offset approximately 400 million dollars of the state's tobacco related medical costs over the first two years of its existence. *See,* 2005 Budget Summary, House Fiscal

Analysis Department, at 84 (September 2005) (projecting a 14% decline in tobacco sales resulting from the HIF) (G 1).[6]

The HIF Act ties the goal of tobacco use reduction with the goal of reducing the health costs arising from smoking. The legislature was mindful that if consumers bore these costs through the fee, consumer behavior would change and the revenues would be diminished. *See, Id.* (projecting a 14% decline in tobacco sales resulting from the HIF) (G 1).

3. The HIF Act Makes the Consumer, Not Distributors, Pay the Health Impacts of Smoking.

The HIF Act puts the financial burden for paying the fee on consumers whose choice to smoke drives the increased medical costs to the state. The HIF Act incorporates the fee directly into the consumer price of cigarettes which is regulated through the Minnesota Unfair Cigarette Sales Act ("UCSA"). *Minn. Stat.* §§ 325D.30 - 325D.42. The UCSA sets minimum pricing for all wholesale and retail transactions of cigarettes. *Minn. Stat.* § 325D.33, subd. 1.

The HIF Act amended the UCSA to include the amount of the fee in the "basic cost of cigarettes." *HIF § 4 (A. 35).* As amended, the "basic cost of cigarettes" is defined as:

> the gross invoice cost of cigarettes to the wholesaler or the retailer plus the full face value of any stamps which may be required by any cigarette

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[6] References to the Governor's Amicus Appendix will be "(G___)."

> tax or *fee* act of this state, unless included in the manufacturer's list price.

Id.; Minn. Stat. § 325D.32, subd. 9 (2005). A wholesaler, which includes a distributor, cannot sell cigarettes for less than the "basic cost of cigarettes" plus the cost of doing business and cartage which is presumed to be 4.5% of the basic cost of cigarettes. *Minn. Stat.* § 325D.32, subd. 10. The distributor fully recovers the cost of the HIF from its sale of cigarettes.[7]

Therefore, the UCSA also requires that the increased cost of cigarettes resulting from the HIF be passed on directly to the consumer. *Minn. Stat.* § 325D.32 and 325D.33, subds. 1 and 8. The only person who is not fully reimbursed for the cost of the HIF is the consumer.

Although the consumers are the intended and ultimate payors of the HIF, the HIF Act permits the Commissioner of Revenue ("Commissioner") to collect the HIF through distributors. *HIF § 2, subd. 4 (A 34).* This is consistent with the regulatory method used for the state's collection of the cigarette tax, which like the HIF, is passed to the consumer. *Minn. Stat. § 297F.09.* Collection of the HIF at the distributor level presents a clear efficiency for the state in administration and collection of the fee. There are significantly fewer distributors than retailers and consumers. In addition, distributors already are subject to the state's extensive regulatory structure regarding

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[7] The HIF Act actually results in higher profits for distributors. If a distributor uses the presumed mark-up method, a distributor is required to sell cigarettes at a presumed mark-up of 4.5% above the basic cost of cigarettes. The $0.75 increase to the basic cost of cigarettes as a result of the HIF results in the distributors making approximately $ 0.037 more per pack of cigarettes. *C.f. Minn. Stat.* § 325D.32, subd. 10.

licensing, stamping product, the filing of reports and returns, and the reporting and auditing framework established under Chapter 297F.[8] The requirement for distributors to initially pay the HIF and recover it down the chain of market transactions reflects efficacy in administration and enforcement and consistency in collection of all fees and taxes related to cigarette transactions.[9]

B. The HIF Act Does Not Substantially Impair the Tobacco Companies' Reasonable Expectations Under the Settlement Agreement.

The Court has recognized a three-part test to review claims for constitutional impairment of a contract right.

> The initial question is whether the state law has, in fact, operated as a substantial impairment of a contractual obligation. The severity of the impairment increases the level of scrutiny to which the legislation is subjected. If there is a substantial impairment, the state, at the second step, must demonstrate a significant and legitimate public purpose behind the legislation. Third, the state's action is examined in the light of this public purpose to see "whether the adjustment of the

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[8] Distributors must keep detailed records of all receipt of product and all sales or transactions. *Minn. Stat.* § 297F.13. Distributors are also responsible for affixing the required stamp on all product prior to delivering product to any other person or at the time a distributor ships product into the state. *Minn. Stat.* § 297F.08. Distributors must submit monthly informational reports to the commissioner. *Minn. Stat.* § 297F11. Distributors must also submit monthly returns reflecting their specific use of the state stamps. *Minn. Stat.* § 297F.09.

[9] For these same reasons, the legislature also moved collection of the sales tax on cigarettes to the distributor level in 2005. *2005 Minn. Laws, 1st Sp. Sess., Ch. 3, Art. 6, § 15 and Art. 5 § 7.*

> rights and responsibilities of the contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption."

Christensen, 331 N.W.2d at 751-52 (citing *Energy Reserves Group v. Kan. Power & Light*, 459 U.S. 400, 412 (1983)).

1. No Significant Impairment.

The HIF Act does not significantly impair the Tobacco Companies' rights under the Settlement Agreement. Even if a substantial impairment is found, the important public purposes furthered by the HIF Act outweigh the minimal impairment of the Tobacco Companies asserted contract rights.

The Tobacco Companies assert that the impairment from the HIF arises because their distributors are required to remit the fee to the state. They assert that these remittances, in conjunction with the Tobacco Companies continuing payments to the state, result in the state receiving "double" payments for health care costs from the Tobacco Companies. The argument fails, however, because the distributor's initial remittance of the HIF to the state, subject to its full reimbursement from retailers and consumers, cannot reasonably be construed as a "double payment" by the Tobacco Companies. Individual consumers were not parties to, or beneficiaries of, the Settlement Agreement.

The requirement that distributors recover the HIF through their sales transactions does not impair the Agreement at all. First, the release provision is limited to matters involving the Tobacco Companies' "future conduct." *Settlement Agreement Part IIIB.b (A 51).* The obligation to

pay the HIF does not arise from any "conduct" by the Tobacco Companies. It is a regulatory requirement generally applicable to all distributors doing business in the state. Second, the HIF is not a "*monetary claim*" against the distributors because the distributors collect the HIF from their sale of products.

Even if the requirement that distributors remit the HIF to the state is an impairment, it is at most a temporary; not a substantial one. In fact, these "pass-through" arrangements are familiar in tobacco regulation. It was in place in relation to the cigarette tax when the Agreement was entered. Given the extensive level of regulation applicable to distributors under Minnesota law, *see e.g., Minn. Stat.* Ch. 297F and *Minn. Stat.* §§ 325D.30-325D.42, the distributors should have expected that this same method of collection might be used by the state in the future.

Because there is no substantial impairment, the legislation is valid. *See e.g., Acton Cosntr. Co. v. Comm'r of Revenue,* 391 N.W.2d 828, 833-834 (Minn. 1986).

2. The HIF Act Furthers Important Public Policy Interests.

Even if the court were to find a "substantial impairment," the legislation is still valid if it serves a significant and legitimate public purpose such as remedying a broad social or economic problem. *See Energy Reserves Group, Inc.,* 450 U.S. at 412. "The requirement of a legitimate public purpose guarantees that the State is exercising its police powers, rather than providing a private benefit." *Id.* Sufficient public purposes are not limited to emergency or temporary situations. *Id.*

It is indisputable that the purpose of reducing tobacco use (particularly among youths) is a significant and legitimate public purpose. The legislature has specifically found that smoking causes serious, chronic and deadly health conditions and that smoking often begins during adolescence. *Minn. Stat.* § 144.391. The link between the higher retail price for tobacco and the health care costs incurred by the state are likewise strong. Consumers are more likely to recognize the harmful and costly effects of their choices if they are responsible to pay for the costs attributable to their behavior. The HIF Act's requirement that consumers bear the burden of funding the state's health costs encourages changes in consumer behavior.

In addition, the HIF's purpose of funding the state's health costs also reflects a significant public purpose. It is undisputed that the state incurs health costs as a result of tobacco use and must be paid by the state from its revenues. The identification of revenue to offset these costs serves an important public purpose. Without such funding, the costs remain and the state will have to pay these costs out of other state revenues.

The link between, health impacts, increased medical costs and the desire to change consumer behavior are all reflected in the legislature's 1985 findings about smoking. *Minn. Stat.* § 144.391. The HIF reflects the most recent legislative attempt to address these persistent and significant public purposes. Further, the importance of these matters to the legislature is reflected in the penalties for noncompliance. The Commissioner is authorized to revoke a distributors' license for failure to comply with the HIF Act. *HIF § 2, subd. 8. (A. 34).* Criminal penalties could also apply. *Minn. Stat.* § 297F.20.

3. The HIF Act Imposes Reasonable Conditions and Is Appropriate to Achieve the Public Purpose.

If the Court determines that the public purposes served by the HIF Act are significant and important, the Court then examines "the state's action . . . in the light of this public purpose to see 'whether the adjustment of the rights and responsibilities of the contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption." *Christensen,* 331 N.W.2d at 751. The HIF Act is a reasonable and appropriate method for achieving the legislature's chosen public purposes.[10]

The HIF was expressly designed to reduce tobacco use, because the revenue generated by the HIF was anticipated to decline as use declined. The use of higher consumer prices is a reasonable and appropriate method of dampening consumer demand for tobacco. In addition, requiring that the consumer's higher price be used directly to offset the state's costs arising from the consumer's choice is also a reasonable and appropriate method to achieve the public purpose. Requiring that the state deposit the HIF funds in the general fund would defeat the

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[10] In *Christensen,* the Court noted that contracts in which the state is a party are subject to stricter scrutiny because of state's "self interest." The HIF does not reflect any attempt by the state to use its legislative police powers for "self-advantage." *Id.*, 331 N.W.2d at 751. In relation to recovery of health costs, the HIF reflects the legislature's desire to hold consumers (not distributors) responsible for these costs. The incidence upon the distributor reflects the state's need for administrative coordination of the HIF with the other cigarette taxes and the substantial existing regulatory structure applicable to distributors. The HIF Act does not in any manner reflect a purpose or intent to permanently impose these costs on distributors.

HIF's purpose of linking consumer behavior to the state's costs arising out of that behavior.

The structure of the HIF to collect the fee at the top of the distribution chain is also a reasonable and appropriate method for the state to achieve the purposes of the HIF. This method of collection is consistent with the extensive regulation of cigarettes at the distributor level under existing law. Given the non-existent or minimal administrative impact to the distributors, prohibiting collection of the fee at the distributor level will result in significant burdens on the state's administration and collection of the HIF.

III. The Court Does Not Need To Decide Whether Minnesota's Health Impact Fee Is A "Fee" Or A "Tax."

The State prevails under the separation of powers analysis and the impairment of contract analysis, regardless of whether the HIF is characterized as a fee, a tax, a hybrid, or something else entirely. As long as the Legislature possessed the valid authority over the subject and the legislation serves an important public purpose, the statute is valid and enforceable.

The legislature has broad authority to enact legislative solutions to meet contemporary problems.

> The legislature is of necessity vested with broad powers to devise ways and means to alleviate adverse and unequal social and economic ills and conditions and to provide for those in want from whatever cause. Such needs have always been matters of public concern and importance and have generally met with prompt and generous

> legislative response. Just what is to be done in any given circumstance evidently must lie within legislative discretion, limited and subject only to constitutional prohibition.

Eldred v. Division of Employment and Sec., Dept. of Social Sec., 295 N.W. 412, 414 (Minn. 1940). The Court should reject the invitation to join a political debate as to the characterization of the legislative powers underlying the HIF statute as a fee versus a tax since it is not necessary to resolve this case.

IV. If The Court Finds Impairment, The Relief Granted Should Be Narrow.

If the Court determines that the HIF Act impairs the Tobacco Companies' substantial contract rights, the Court should require that any remedy be limited to preserve as much of the HIF Act as possible.

In this case, the HIF Act has two express purposes. The Tobacco Companies assert that only the second purpose – the recovery of health costs – violates their rights under the Settlement Agreement. In relation to the Tobacco Companies' distributors, the Court should uphold application of the HIF based on the purpose of reducing smoking, particularly among youths. If necessary, the Court could direct the payments from the Tobacco Companies' distributors to the general fund. This remedy preserves the consumer payments under the HIF Act and permit application of the HIF Act in its current form as to the distributors for the non-settling tobacco companies.

If the Court precludes the state's ability to collect the HIF from the Tobacco Companies' distributors, the Court should expressly preserve the state's ability to collect the

HIF for tobacco products not subject to the Settlement Agreement. The Court should further preserve the state's ability to collect the HIF on the Tobacco Companies' products at the retail level, including the right to retroactively collect the fee at the retail level. The Settlement Agreement only applies to the Tobacco Companies and their distributors. *(A 50).* The release provision of the Settlement Agreement does not apply to retailers who sell the Tobacco Companies' products to consumers.[11] *Id.*

The Act imposes the HIF on multiple levels of transactions involving cigarettes – including the sale or possession of cigarettes in this state with the intent to sell. *HIF § 2, subd. 3(a) (A 33).* If collection is denied at the distributor level, the HIF Act grants the Commissioner the use of the powers enumerated in Minn. Stat. Chs. 297F and 270C. *HIF § 2 subd. 6 (A 34).* These provisions allow the Commissioner to establish procedures, forms and materials to collect the HIF from retailers. *Id.*

If the state's ability to collect the HIF at the retail level is preserved, the Court should deny the Intervenors' claims. The state's continued collection of the HIF from their distributors does not impair their constitutional rights.

CONCLUSION

The Settlement Agreement cannot, and should not, be read to impair the legislature's power to enact the HIF

[11] The Governor outlined the legal basis for the collection of the HIF at the retail level in the Governor's Memorandum in Opposition to the Intervenors' Claims.

Act. Under the separation of powers doctrine, the attorney general may not surrender the regulatory power of the legislature. Further, even if the attorney general could contract to limit future legislative acts, the significant public purposes served by the HIF outweigh any minimal impairment of the Tobacco Companies' rights.

The Court should reverse the decision of the district court and uphold application of the HIF Act to all licensed distributors in Minnesota.

Respectfully Submitted,

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CERTIFICATE OF COMPLIANCE WITH MINN. R. APP. P. 132.01 SUBD. 3

The undersigned certifies that the Amicus Brief submitted herein contains 6,641 words and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedures 132. The Amicus Brief was prepared using a proportional spaced font of 13 pt. The word count is stated in reliance on Microsoft Word 2003.

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[The appendix to this Amicus Brief consisted of the 2005 Budget Summary, House Fiscal Analysis Department, Table 1. It has been omitted for printing.]

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In The

Supreme Court of the United States

PHILIP MORRIS USA, INC., *ET AL.*,

Petitioners,

v.

STATE OF MINNESOTA,

Respondents.

On Petition for a Writ of Certiorari to the Minnesota Supreme Court

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PETITIONER'S REPLY BRIEF

The Petition raises an issue of extraordinary importance: whether the federal Contracts Clause requires a state to keep its word when it enters into a proprietary contract. Relying on a fundamental misreading of this Court's plurality opinion in *United States v. Winstar Corp.*, 518 U.S. 839 (1996) -- a case that has generated widespread confusion in the lower courts -- the Minnesota Supreme Court held that a state can impair such a contract at will as long as it does so through legislation that was not expressly barred by an "unmistakable promise" in the contract. Because few, if any, contracts *ever* satisfy such a standard, this Court should grant *certiorari* and clarify that the unmistakability doctrine does not apply to a state's proprietary contracts and that the Contracts Clause requires a state to keep its promises.

For over 130 years, this Court has interpreted the federal Contracts Clause as prohibiting state legislation that impairs proprietary contracts. This Court has made clear that states are not free to enact legislation that impairs their financial contractual obligations -- notwithstanding that such contracts ordinarily do not contain an explicit, "unmistakable" promise not to enact such legislation. Yet, by its decision, the Minnesota court transformed the Contracts Clause into an impotent mechanism to enforce proprietary contractual promises. Given the importance of this issue and the confusion engendered by *Winstar*, this Court should grant review. As the *Winstar* plurality itself recognized, this issue is vital because the proper application of the unmistakability doctrine implicates "the Government's own long-run interest as a reliable contracting partner." *Id.* at 883.

Perhaps recognizing the tenuous nature of the Minnesota court's ruling, Respondent spends much of its brief arguing that the Minnesota court relied exclusively on state grounds and that, therefore, this Court does not have jurisdiction. But the Minnesota court could not have avoided -- and did not avoid -- the federal constitutional issue by applying state law. The very purpose of the Contracts Clause is to provide federal protection against the abuse of state power, including the parochial interpretation of state laws by state courts. In upholding the Health Impact Fee under state law, the Minnesota court thus made consideration of the federal issue necessary. Furthermore, in purporting to apply state law, the Minnesota court principally relied on (albeit incorrectly) a federal case -- this Court's *Winstar* decision. The court looked to that federal case because it has long interpreted the Minnesota Contracts Clause as being coextensive with its federal counterpart. *See Christensen v. Minneapolis Mun. Employees Ret. Bd.*, 331 N.W.2d 740, 750-52 (Minn. 1983). Thus, the Minnesota court did address a federal issue. A federal question is squarely presented here, and this Court should grant review.

I. THE EXTENT TO WHICH THE UNMISTAKABILITY DOCTRINE APPLIES TO PROPRIETARY STATE CONTRACTS IS IN NEED OF CLARIFICATION BY THIS COURT.

In return for billions of dollars in payments made and to be made every year *in perpetuity* (as well as other consideration), Minnesota agreed not to seek the reimbursement of additional state heath care costs attributable to smoking from Petitioners. Yet, in enacting the Health Impact Fee, Minnesota has done precisely that: impose additional liability on defendants and their distributors for smoking-related health care costs. Petition ("Pet.") at 3-15. Notwithstanding that the contract was proprietary in nature, the Minnesota Supreme Court upheld the legislative

impairment by applying the unmistakability doctrine. Because the contract did not contain a second, unmistakable promise by Respondent not to impair its contractual obligations through legislation, the court upheld the impairment.

Respondent justifies this result by arguing that "Petitioners' assertion that the unmistakability doctrine does not apply to contracts a state enters into in its proprietary capacity is plainly incorrect." *See* Brief in Opposition ("Opp.") at 16 n.7. According to Respondent, the unmistakability doctrine applies to proprietary contracts. In fact, this Court has never applied that doctrine to such a contract.[1] In *Murray v. City of Charleston*, 96 U.S. 432 (1877), *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977), as well as in other decisions, this Court has

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[1] Respondent cites *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982), as consistent with the holding below, Opp. at 19-21, but that case is entirely inapposite because it involved a purportedly sovereign contract. In *Merrion*, lessees contracted for mining rights on an Indian tribe's land. *Id.* at 146. The lessees, seeking to invalidate a later severance tax on oil and gas, argued that the contract was sovereign -- not proprietary -- and waived all of the tribe's sovereign power. Specifically, the lessees argued that an Indian tribe's sovereign power over non-tribe members derives wholly from the power to control entry onto tribal land. By allowing the lessees onto tribal land, the lessees argued, the tribe contractually "exempt[ed] them from [all] further exercises of the Tribe's sovereign authority." *Id.* at 145. This Court rejected the proffered limitation on the tribes' sovereign authority, instead holding that Indian tribes have the same sovereign power to tax non-tribe members as they do tribe-members. Once the Court reached this holding, it was a foregone conclusion that there was no "clear and unmistakable surrender of taxing power" in the leases. *Id.* at 148. Conversely, here, Petitioners do not argue that the settlement agreement effected a waiver of any sovereign power. Rather, both parties agree that the settlement agreement is a proprietary contract, and Petitioners contend that the Health Impact Fee impairs that contract by imposing the very liability for tobacco-related health care costs that the contract expressly released.

invalidated state legislation impairing a state's proprietary contractual obligations without applying the unmistakability doctrine. In doing so, this Court has made clear that the Contracts Clause subjects a state's proprietary contracts to the same contract-interpretation rules that apply to contracts between private parties. *See, e.g.*, *Winstar*, 518 U.S. at 887 n.32 ("[T]he Government is ordinarily treated just like a private party in its contractual dealings."); *U.S. Trust Co. of N.Y.*, 431 U.S. at 25 n.23 ("States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons.") (quoting *Murray*, 96 U.S. at 445); *Lynch v. United States*, 292 U.S. 571, 579 (1934) (When the government acts as a private contracting party, "its rights and duties are therein governed generally by the law applicable to contracts between private individuals.").[2]

Indeed, Respondent later *admits* that the unmistakability doctrine does not apply to at least some proprietary contracts. Opp. at 15 n.7 (conceding that *Murray* and *United States Trust* show that "some Contracts Clause cases involving proprietary contracts do not require application of the unmistakability doctrine"). But the distinction it draws between circumstances in which the doctrine does and does not apply is untenable. Under the

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[2] *See also Wood v. Lovett*, 313 U.S. 362, 368-69 (1941) (the Contracts Clause prohibited Alabama from repealing a statute creating a contractual obligation for Alabama to honor its sale of property for nonpayment of taxes); *Louisiana ex rel. Hubert v. City of New Orleans*, 215 U.S. 170 (1909) (the Contracts Clause prohibited Louisiana from passing a statute prohibiting the payment of money owed pursuant to contracts entered into by municipalities with the police board pursuant to a delegation of authority from the state).

Minnesota court's analysis, whenever a state chooses to impair a proprietary contract through a legislative act, the unmistakability doctrine would apply to defeat a Contracts Clause challenge. The reasoning is that, under such circumstances, the private party invoking the Contracts Clause inevitably challenges a state statute and necessarily would have to assert that the contract involves the "surrender of a sovereign power;" therefore, the unmistakability doctrine applies, even if the contract is proprietary. Op. at 14-15.

This approach conflicts with the express text of the Contracts Clause, which protects against attempts by a state to impair its own contractual obligations *through legislation*. *See* U.S. Const. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . *Law* impairing the Obligation of Contracts.") (emphasis added). Indeed, the Clause was included in Article I, Section 10's list of prohibitions on state legislation precisely because the Framers foresaw the great temptation for state legislatures to use their sovereign power to evade inconvenient financial contractual commitments. *See Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 137-39 (1810) (Contracts Clause must be more strictly applied to state contracts than to contracts between private parties). This Court has therefore long held that "impairments of a State's own contracts . . . face more stringent examination under the Contracts Clause than would laws regulating contractual relationships between private parties." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 n.15 (1978) (describing *U.S. Trust Co. of N.Y.*, 431 U.S. at 22-23). This is why, in cases like *Murray* and *United States Trust*, this Court struck down legislative attempts by states to impair their contractual obligations -- without applying the unmistakability doctrine.

Furthermore, the Minnesota court's flawed approach subjects a state's impairment of its own contractual obligations to *less scrutiny* than impairments of agreements between private parties receive; under its analysis, a state therefore has a *greater* ability to impair its own proprietary

contracts than it has to impair contracts between private parties. The Minnesota court's decision effectively nullifies a central purpose of the Contracts Clause by rendering state financial contracts vulnerable to precisely the form of legislative impairment that the Constitution is meant to foreclose. The decision thus sends a message to state legislatures that they can evade an inconvenient contractual commitment so long as they impair the contract through a form of legislation that the contract itself failed to anticipate and bar expressly.

Ultimately, Respondent's attempt to distinguish between legislative impairments and non-legislative breaches, reflects the confusion created on this issue by *Winstar*. Respondent quotes and relies on a snippet from *Winstar*: the plurality's statement that the application of the doctrine "turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power." Opp. at 15 (quoting *Winstar*, 518 U.S. at 879). To be sure, this *Winstar* quote, taken in isolation, could be read to support the Minnesota court's position. But, when read with the rest of *Winstar*, it does not support the proposition that the unmistakability doctrine applies to all state contracts that are legislatively impaired.

The *Winstar* plurality explained that "[t]he application of the doctrine . . . differ[s] according to the different kinds of obligations the Government may assume *and* the consequences of enforcing them." *Id.* (emphasis added). *Winstar* did not involve a proprietary contract, and the plurality's discussion of the unmistakability doctrine does not endorse application of that doctrine to proprietary contracts, whether the impairment occurs through legislation or otherwise. Rather, *Winstar* mandated a two-step inquiry beginning with the question of whether the contract is proprietary or sovereign. If the contract is proprietary -- *i.e.*, a commercial contract that does not on its face purport to surrender the state's sovereign powers -- the unmistakability

doctrine does not apply. *Id.* ("[N]o one would seriously contend that enforcement of humdrum supply contracts might be subject to the unmistakability doctrine."). If the contract is sovereign -- *i.e.*, allegedly surrenders a sovereign power -- the unmistakability doctrine applies if the relief requested "would block the exercise of a sovereign power." *Id.* at 879.

The *Winstar* plurality opinion -- read in full -- thus does not give states license to impair proprietary contracts through legislation. *Winstar* is fully consistent with *Murray*, *United States Trust*, and 130 years of this Court's jurisprudence -- all of which reject the Minnesota Supreme Court's analysis, and none of which the *Winstar* plurality purported to overrule. Yet, as Respondent concedes, post-*Winstar*, the lower courts have frequently acknowledged confusion about the diversity of interpretations of the unmistakability doctrine that case produced. *See* Opp. at 28; Pet. at 18-19 (collecting cases and academic commentary). The lower courts have become confused by a fractured decision of this Court and have misread the plurality opinion in a way that conflicts with longstanding precedent and eviscerates a central Constitutional protection. This Court needs to provide further guidance.

Finally, Respondent errs in asserting that special state law rules governing the interpretation of state contracts can make the Contracts Clause inapplicable. *See* Opp. at 9-10. This Court foreclosed recourse to state law as a means of evading the constraints of the Contracts Clause over 100 years ago in *Murray*. There, the City, like Respondent here, argued that the federal Contracts Clause was not implicated because, under state law rules of construction, the contract should be interpreted as allowing the sovereign to impair its terms through taxing legislation. *See* 96 U.S. at 444. This Court rejected the argument:

> It is against the rules, both of law and of reason, to admit by implication in the construction of a contract a principle which

> goes in destruction of it. The truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons. Hence, instead of there being in the undertaking of a State or city to pay, a reservation of a sovereign right to withhold payment, the contract should be regarded as an assurance that such a right will not be exercised. *A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity.*

Id. at 445 (emphasis added). Similarly, when Respondent, in its proprietary capacity, entered into a contract releasing Petitioners from liability for reimbursement of financial costs in exchange for financial and other consideration, it "c[a]me down to the level of ordinary individuals" and the "contract[] ha[s] the same meaning as that of similar contracts between private persons." *Id.* To allow Respondent "to deny or change the effect of the promise" through subsequent legislation, as the Minnesota court has done, would be "an absurdity." *Id.*

In sum, application of the unmistakability doctrine to proprietary contracts would eliminate any meaningful protection of the Contracts Clause with respect to most state contracts. It would give states virtually unbridled power to abrogate any contract as long as they do so through legislation, especially through utilization of the taxing power. Absent assurance that states will be required to keep their promises, few parties will be willing "to undertake the risk of government contracting." *Winstar*, 518 U.S. at 913 (Breyer, J., concurring). And where, like here, the contract involves a significant amount of money, the risks undertaken by the contracting party would be completely unacceptable. Given

the importance of this issue to states and their contracting partners, lower courts and commentators have repeatedly asked this Court for additional guidance on the parameters of *Winstar*. This case provides an ideal vehicle for the Court to do so.

II. THIS COURT HAS, AND SHOULD EXERCISE, JURISDICTION.

Respondent also argues that this Court lacks jurisdiction because the Minnesota court did not cite to or rely upon the federal Contracts Clause in reaching in its decision (even though it is undisputed that Petitioners raised and fully briefed the issue below). *See* Opp. at 6-13. This argument is meritless. Whether or not the Minnesota court expressly addressed the issue below, the Contracts Clause is designed to provide federal protection against precisely the type of governmental impairment of contract at issue in this case. A federal issue is therefore clearly presented by the Petition.

In any event, the Minnesota court relied almost exclusively on this Court's opinion in *Winstar* to interpret the scope of its own constitutional provision. Accordingly, the court below necessarily addressed a federal question, and this Court has jurisdiction to review its determination. *See, e.g.*, *Delaware v. Prouse*, 440 U.S. 648, 652 (1979) (This Court has jurisdiction to review a state court's judgment where a state constitutional provision "will automatically be interpreted at least as broadly as [its federal counterpart]."); *Enter. Irrigation Dist. v. Farmers' Mut. Canal Co.*, 243 U.S. 157, 164 (1917) ("[W]here the non-Federal ground is so interwoven with the [federal question] as not to be an independent matter, or is not of sufficient breadth to sustain

the judgment without any decision of the other, our jurisdiction is plain.").[3]

Indeed, as the Petition demonstrates, Pet. at 15, without the erroneous application of the unmistakability doctrine, the Minnesota court likely would have ruled in Petitioners' favor. The fact that a lone concurring justice stated that he would have reached the same conclusion without applying the doctrine simply confirms this. If anything can be inferred from the concurring opinion, it is that the other justices, who did not join the opinion, disagreed with the reasoning contained therein.

CONCLUSION

This Court should grant *certiorari* to clarify that its plurality decision in *Winstar* did not reverse its longstanding jurisprudence that the unmistakability doctrine does not apply to contracts that a state enters into in its proprietary capacity.

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[3] The decisions cited by Respondent are inapposite because they involved state law grounds that were clearly independent of the federal challenge. For example, in *Coleman v. Thompson*, 501 U.S. 722 (1991) (cited in Opp. at 7), this Court found that a state court decision dismissing an appeal for petitioner's "failure to meet the [Virginia] Supreme Court's time requirements" rested on an independent and adequate state ground because the dismissal was the result of the state law rule that would apply no matter how the federal issue was decided. *Id.* at 740-41. Similarly, in *Herb v. Pitcairn*, 324 U.S. 117 (1945) (cited in Opp. at 7), this Court would not exercise jurisdiction until the Illinois Supreme Court clarified whether its holding was based on the independent and adequate state ground that petitioners had no actual case pending. *Id.* at 127. But where, as here, the state law question is "interwoven with the federal [question]" it is not "independent," and does not foreclose review by this Court. *Michigan v. Long*, 463 U.S. 1032, 1040 (1983).

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